Supreme Court, U.S.
FILED

941183 DEC 30 1994

OFFICE OF THE CLERK

No. 95-

In the Supreme Court of the United States

OCTOBER TERM, 1994

NORAM ENERGY CORP.,
Petitioner,

v.

THE UNITED STATES,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

PETITION FOR WRIT OF CERTIORARI

LAWRENCE L. JONES
Counsel of Record
J. EDGERTON PIERSON, JR.
BLANCHARD, WALKER,
O'QUIN & ROBERTS
(A Professional Law Corporation)
1400 Premier Bank Tower
Shreveport, Louisiana 71101
(318)221-6858

FREDERICK R. PARKER, JR.
Beck Building
400 Travis Street
Shreveport, Louisiana 71101
(318)221-4396

Counsel for Petitioner

December 30, 1994

56

QUESTIONS PRESENTED FOR REVIEW

1. Whether the Federal Circuit erred, in conflict with this Court's holdings in *Comm'r v. Sunnen*, 333 U.S. 591, 68 S.Ct. 715, 92 L.Ed.2d 898 (1948) and *Limbach v. Hooven & Allison Co.*, 466 U.S. 353, 104 S.Ct. 1837, 80 L.Ed.2d 356 (1984), by applying collateral estoppel in a federal income tax case to bar the Petitioner from litigating a purely legal issue in the following distinct settings:

> A. When it held, with respect to one taxable year, that the Petitioner was barred from litigating the depreciable character of line pack gas by a Fifth Circuit opinion which found an entirely separate, but functionally-similar, asset (cushion gas placed in service during an earlier taxable year) to be non-depreciable.
>
> B. When it held that the Petitioner was barred from litigating the depreciable character of the portion of cushion gas (a fungible asset) placed in service during *one* taxable year, where (under prior law) the Fifth Circuit had found the portion of that asset placed in service during a *prior* taxable year to be non-depreciable.

2. Whether the Federal Circuit erred in applying collateral estoppel to prevent the Petitioner from litigating a purely legal issue which it previously had lost in the Fifth Circuit, under circumstances where the two circuits have adopted conflicting rules of law (or, conversely, whether a taxpayer who raises an issue of law within any particular circuit is entitled to be treated the same as all other taxpayers who raise the same issue within that circuit) - this question poses directly the issue which Justice Byron R. White addressed in his concurring opinion in *United States v. Stauffer Chemical Co.*, 464 U.S. 165, 104 S.Ct. 575, 78 L.Ed.2d. 388 (1984), but which has yet to be addressed by the majority of this Court.

PARTIES TO THE PROCEEDING AND RULE 29.1 STATEMENT

The Petitioner is NorAm Energy Corp. On May 10, 1994, the shareholders of Arkla, Inc. approved the change of name from Arkla, Inc. to NorAm Energy Corp., which name change was formally filed with the Secretary of State of the State of Delaware on May 11, 1994. The proceedings below were conducted in the name of Arkla, Inc. NorAm Energy Corp. has only wholly-owned subsidiaries, and is a publicly-traded corporation listed on the New York Stock Exchange. The Respondent is the United States.

TABLE OF CONTENTS

QUESTIONS PRESENTED FOR REVIEW i

PARTIES TO THE PROCEEDING AND RULE 29.1 STATEMENT ii

TABLE OF CONTENTS iii

TABLE OF AUTHORITIES v

OPINIONS BELOW 2

JURISDICTION 2

STATUTORY AND REGULATORY PROVISIONS INVOLVED 2

STATEMENT OF THE CASE 3

REASONS FOR GRANTING WRIT 6

Conflicting Decisions 9

Unresolved Question 10

I. The Federal Circuit Erred by Disregarding the Factual Distinctions Between this Case and *Arkla I* 10

A. The *Sunnen* "Separable Facts" Analysis Applies in the Tax Setting Without Regard to Questions of "Materiality" 11

B. The *Montana* Holding is Inapposite to This Case 13

II. Because This Case Involves an Intervening Change in the Law, the Application of Collateral Estoppel Here Would Result in the Inequitable Administration of the Revenue Laws 15

III. Collateral Estoppel Does Not Apply Where There Exists a Conflict Among the Circuits With Respect to the Substantive Merits of a Case 19

CONCLUSION 22

TABLE OF AUTHORITIES

Cases

Allen v. McCurry,
449 U.S. 90, at 95-96, 101 S.Ct. 441,
66 L.Ed.2d 308 (1980) 14, 22

Arkla, Inc. v. The United States,
27 Fed. Cl. 226 (1992) 2

Arkla, Inc. v. The United States,
37 F.3d 621 (Fed. Cir. 1994) 2

Arkla, Inc. v. The United States,
765 F.2d 487 (5th Cir. 1985) 4-7, 10, 11, 13-19, 22, 24

Arkla, Inc. v. The United States
Unreported (September 13, 1993) 2

Comm'r v. Sunnen,
333 U.S. 591, 68 S.Ct. 715,
92 L.Ed.2d 898 (1948) . . . . . i, 6-15, 18, 19, 23, 24

Limbach v. Hooven & Allison Co.,
466 U.S. 353, 104 S.Ct. 1837,
80 L.Ed.2d 356 (1984) . . . i, 7, 9, 12, 13, 15, 16, 18, 19, 23, 24

Montana v. United States,
440 U.S. 147, 59 L. Ed. 2d 210,
99 S. Ct. 970 (1979) 9-16, 19, 23

Transwestern Pipeline Company v.
United States, 639 F.2d 679,
225 Cl. Ct. 999 (1980) 4, 5, 7, 16-18, 22, 23

United States v. Stauffer Chemical Co.,
464 U.S. 165, 104 S.Ct. 575,
78 L.Ed.2d. 388 (1984) . . . . . i, 7, 12, 14, 19-24

Statutes

26 U.S.C. §38 . . . . . 2, 3

26 U.S.C. §48 2

26 U.S.C. §167 . . . . . 2, 4, 5

26 U.S.C. §168 . . . . . 2, 3, 5, 16, 23

28 U.S.C. §1254(1) 2

28 U.S.C. §1346(a) 3

Proposed Treasury Regulations 1.168-2(l)(2) 2

Treasury Regulation §1.167(a)-2 2

Treasury Regulations §§1.167(a)-1(a) 2

Other Authorities

Economic Recovery Tax Act of 1981 5

Rules of the United States Court of Federal Claims,
Rule 18(c) 11

NO. 95-_____

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1994

NORAM ENERGY CORP.,

Petitioner,

v.

THE UNITED STATES,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

PETITION FOR WRIT OF CERTIORARI

TO THE HONORABLE THE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES

NORAM ENERGY CORP. respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Federal Circuit entered in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Federal Circuit is reported at *Arkla, Inc. v. The United States*, 37 F.3d 621 (Fed. Cir. 1994) (App. A, *infra*, p. 1a.). The opinion of the United States Court of Federal Claims rendered December 3, 1992 is reported at *Arkla, Inc. v. The United States*, 27 Fed. Cl. 226 (1992) (App. B, *infra*, p. 15a.). The unreported opinion of the United States Court of Federal Claims in *Arkla, Inc. v. The United States* rendered September 13, 1993 appears in the Appendix (App. C, *infra*, p. 33a.).

JURISDICTION

The opinion of the United States Court of Appeals for the Federal Circuit was entered as its judgment on October 4, 1994 (App. A, *infra*, p. 1a.) and this Petition for Writ of Certiorari was filed within ninety (90) days of that date. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

This case involves 26 U.S.C. §§38, 48, 167 and 168; Treas. Regs. §§1.167(a)-1(a), and 1.167(a)-2; and Proposed Treas. Reg. 1.168-2(l)(2) (the statutory and regulatory provisions are set forth in the foregoing order in App. D, *infra*, beginning on p. 39a.).

STATEMENT OF THE CASE

This proceeding involves the Petitioner's claim for refund of United States corporate income taxes. The suit was initiated in the United States Court of Federal Claims (the "Trial Court") pursuant to 28 U.S.C. §1346(a), where the Petitioner asserted its entitlement to accelerated cost recovery system ("ACRS") deductions[1] for its 1981, 1982, 1983 and 1984 tax years with respect to certain volumes of "line pack gas"[2] and "cushion gas"[3] which it injected during 1981 for use in its natural gas pipeline system and its Chiles Dome gas storage facility,[4] respectively. The suit also involves the Petitioner's entitlement to the investment tax credit[5] for its 1981 tax year with respect to these assets.

The suit arose from the Internal Revenue Service having disallowed, on audit, the ACRS deductions and the investment tax credits which the Petitioner claimed on its tax returns filed for the years at issue. These deductions and tax credits were disallowed under the theory that line pack gas and cushion gas constituted part of the Petitioner's inventory and, accordingly, were not capital assets to which the claimed deductions and credits would apply.

---

[1]Under the provisions of Section 168 of the Internal Revenue Code of 1954 (the "Code,") the provisions of which appear in Title 26 U.S.C.)

[2]"Line pack gas" is that volume of natural gas which must always be present in a natural gas pipeline system in order for the system to function.

[3]"Cushion gas" is natural gas employed in a gas storage facility to provide the minimum pressure required for facility operations, and is the functional equivalent of line pack gas.

[4]Chiles Dome was a depleted gas field located in Eastern Oklahoma which the Petitioner acquired in the late 1970's and converted into a gas storage facility at a total cost of approximately $50,000,000.00. Of this total cost, $18,000,000.00 represented the cost of the 14 BCF of natural gas which the Petitioner acquired to provide the minimum operating pressure necessary to operate the facility (*i.e.*, the cushion gas).

[5]Under the provisions of §38 of the Code.

The Petitioner subsequently paid the additional taxes alleged to be due, filed administrative claims for refund, and instituted this action after the Internal Revenue Service denied the refund claims.

In its answer to the Petitioner's complaint, the Respondent denied the Petitioner's entitlement to the ACRS deductions and the investment tax credits with respect to both the cushion gas and the line pack gas at issue. Also, with respect to the Petitioner's cushion gas, the Respondent affirmatively pled that the Petitioner was collaterally estopped by the decision of the United States Court of Appeals for the Fifth Circuit in *Arkla, Inc. v. The United States*, 765 F.2d 487 (5th Cir. 1985) ("*Arkla I*"), from litigating its entitlement to these deductions and tax credits. The Respondent did not raise collateral estoppel as a defense to the Petitioner's claims with respect to the separate line pack gas issue.

Arkla I involved the availability of the investment tax credit with respect to the economically-recoverable volume of the cushion gas which the Petitioner had injected into its Chiles Dome gas storage facility during the 1980 tax year. Finding in favor of the Petitioner in *Arkla I*, the United States District Court for the Western District of Louisiana cited and expressly relied upon the decision of the United States Court of Claims in *Transwestern Pipeline Company v. United States*, 639 F.2d 679, 225 Cl. Ct. 999 (1980). The Court of Claims had held in *Transwestern* that line pack gas employed in a natural gas pipeline system (the functional equivalent of cushion gas employed in an underground gas storage reservoir) was a capital asset subject to the allowance for depreciation under Section 167 of the Code, and that the portion of that asset which would be economically recoverable upon abandonment of the pipeline system represented merely the salvage value of the line pack gas as a whole.

Considering *Arkla I* on appeal, the Fifth Circuit reversed the holding of the District Court and held, contrary to the Court of Claims in *Transwestern*, that the economically recoverable and nonrecoverable volumes of the cushion gas there at issue constituted separate and distinct assets. The Fifth Circuit further held that, since no economic loss would be suffered with respect

to the economically-recoverable cushion gas, this separate asset was not property subject to the allowance for depreciation and, accordingly, did not qualify for the investment tax credit. *Arkla I*, *supra* at 490.

The Trial Court decided the present case after considering two separate cross motions for summary judgment, one of which dealt with the Petitioner's cushion gas and the other with its line pack gas. The Trial Court first held, with respect to the cushion gas issue, that the Petitioner was collaterally estopped by the Fifth Circuit's decision in *Arkla I* from litigating the issue as to whether the cushion gas placed in service in 1981 was eligible for ACRS deductions under Section 168 and the investment tax credit under Section 38. As noted above, *Arkla I* involved the question of whether the economically-recoverable volume of the cushion gas placed in service in 1980 was property of a character subject to the allowance for depreciation under Section 167 of the Code. The Trial Court's collateral estoppel analysis rested upon its conclusion that the enactment of the Economic Recovery Tax Act of 1981, which first incorporated Section 168 as a part of the Code and eliminated salvage value from the depreciation equation, did not represent such a change in the controlling law as to preclude application of collateral estoppel. Notwithstanding its collateral estoppel holding, the Trial Court went on to consider the merits of the cushion gas issue and followed the Fifth Circuit's holding in *Arkla I* by distinguishing *Transwestern*.

The Trial Court rendered a separate opinion with respect to whether the line pack gas which the Petitioner placed in service in 1981 was eligible for the claimed ACRS deductions and the investment tax credit. Although the Trial Court held that the Petitioner was entitled to recover under the *Transwestern* decision with respect to its line pack gas, it limited its opinion to the economically-nonrecoverable volume of that asset. The Trial Court thus entered partial judgment in favor of the Petitioner based on the parties' stipulation that 30% of the line pack gas would not be economically recoverable upon abandonment of the pipeline facility.

In its appeal to the Federal Circuit, the Petitioner set forth the following issues for review:

1. Whether the Trial Court erred as a matter of law in holding that neither ACRS deductions or the investment tax credit are available with respect to the economically-recoverable (salvageable) line pack gas which the Petitioner placed in service in 1981;

2. Whether the Trial Court erred as a matter of law in holding that neither ACRS deductions or the investment tax credit are available with respect to the economically-recoverable (salvageable) cushion gas which the Petitioner placed in service in 1981; and

3. Whether the Trial Court erred as a matter of law in holding that the Petitioner was collaterally estopped by the Fifth Circuit's decision in *Arkla I* from litigating the issue of whether the economically-recoverable volume of cushion gas which the Petitioner placed in service in 1981 was eligible for the ACRS deductions and the investment tax credit under provisions of the law which had been amended with respect to property placed in service after 1980.

The Federal Circuit held that the Petitioner was collaterally estopped by the Fifth Circuit's decision in *Arkla I* from bringing its claims with respect to *both* the line pack gas and the cushion gas issues. The Federal Circuit thus never reached the substantive issues presented in this case. This Petition followed.

REASONS FOR GRANTING WRIT

The Federal Circuit's opinion directly conflicts with the established jurisprudence of this Court in three fundamental respects. First, by rejecting the Petitioner's right to litigate the depreciable nature of its economically-recoverable line pack gas, based on another circuit's consideration of the depreciable character of an entirely separate asset (cushion gas), the Federal Circuit disregarded this Court's fundamental holdings in *Comm'r*

v. Sunnen, 333 U.S. 591, 68 S.Ct. 715, 92 L.Ed. 898 (1948), and *Limbach v. Hooven & Allison Co.*, 466 U.S. 353, 104 S. Ct. 1837, 80 L. Ed.2d 356 (1984) ("Hooven II"). Second, the Federal Circuit erred by disregarding the fact that the assets at issue here were placed in service following a significant change in the law which Congress implemented with respect to taxable years after 1980, the year at issue in *Arkla I*, again in direct conflict with *Sunnen* and *Hooven II*. Finally, the Federal Circuit erred by applying collateral estoppel in this case because it previously had adopted a rule of law on the merits, in *Transwestern*, completely at odds with the Fifth Circuit's analysis in *Arkla I*. Accordingly, this case, if allowed to stand, would result in the very disparate treatment of different taxpayers within the same circuit which Justice White expressly rejected in his concurring opinion in *United States v. Stauffer Chemical Co.*, 464 U.S. 165, 104 S. Ct. 575, 78 L. Ed.2d 388 (1984).

The Federal Circuit's broad construction of collateral estoppel in the case below goes far beyond the traditional boundaries which this Court has imposed upon application of the doctrine in tax cases. Recognizing that collateral estoppel poses a particular risk of inequality in the administration of the law when it is applied in such cases, the *Sunnen* Court concluded that the reasons underlying the doctrine's development often do not support its application:

> . . .Collateral estoppel is a doctrine capable of being applied so as to avoid an undue disparity in the impact of income tax liability. A taxpayer may secure a judicial determination of a particular tax matter, a matter which may recur without substantial variation for some years thereafter. But a subsequent modification of the significant facts or a change or development in the controlling legal principles may make that determination obsolete or erroneous, at least for future purposes. If such a determination is then perpetuated each succeeding year as to the taxpayer involved in the original litigation, he is accorded a tax treatment

> different from that given to other taxpayers of the same class. As a result, there are inequalities in the administration of the revenue laws, discriminatory distinctions in tax liability, and a fertile basis for litigious confusion. . . .Such consequences, however, are neither necessitated nor justified by the principle of collateral estoppel. 333 U.S. at 599; 92 L.Ed. at 906, 907.

In light of this potential for the inequitable application of the revenue laws, the *Sunnen* Court held that, in tax cases, the doctrine may be applied only in certain narrowly-defined circumstances:

> It must be confined to situations where the matter raised in the second suit is *identical in all respects* with that decided in the first proceeding *and where the controlling facts and applicable legal rules remain unchanged.* 333 U.S. at 599; 92 L.Ed. at 907 (emphasis added).

Finally, the *Sunnen* Court concluded that the doctrine will not preclude a taxpayer from litigating a case which poses facts separable from, though identical to, those which were at issue in an earlier proceeding:

> . . .*[i]f the relevant facts in the two cases are separable, even though they may be similar or identical, collateral estoppel does not govern the legal issues which recur in the second case.* Thus the second may involve an instrument or transaction identical with, but in a form separable from, the one dealt with in the first proceeding. In that situation, a court is free in the second proceeding to make an independent examination of the legal matters at issue. It may then reach a different result or, if consistency in decisions is considered just and desirable, reliance may be placed upon the ordinary rule of *stare decisis. Before a party can invoke the collateral estoppel*

> *doctrine in these circumstances, the legal matter raised in the second proceeding must involve the same set of events and the same bundle of legal principles that contributed to the rendering of the first judgment.* 333 U.S. at 601, 602; 92 L.Ed. at 908 (emphasis added).

The *Sunnen* Court applied this analysis to deny operation of the doctrine in a tax proceeding concerning the imputation of income under a contract, all of the essential terms of which were identical to a contract involved in an earlier case, and concluded that:

> For income tax purposes, what is decided as to one contract is not conclusive as to any other contract which has not been in issue, however similar or identical it may be. 333 U.S. at 602; 92 L.Ed.2d at 908.

The *Sunnen* case thus has come to stand for the proposition that preclusion should be denied in federal tax matters either (1) where the facts of the second case, though legally indistinguishable from those of the first, are not the same closed set of historic facts underlying the decision of the same issue in the earlier proceeding, or (2) where there has been an intervening change in the law. By applying collateral estoppel in this case which manifests both of these proscriptive factors, the Federal Circuit applied the doctrine in a manner which seriously undermines the limitations imposed by this Court in *Sunnen*. The application of the doctrine in this case thus raises the following issues which can be resolved only by this Court:

1. Conflicting Decisions. Whether the decision in *Sunnen*, which this Court subsequently cited with approval in *Hooven II*, has been modified by the intervening case of *Montana v. United States*, 440 U.S. 147, 59 L. Ed. 2d 210, 99 S. Ct. 970 (1979), in the manner implied by the Federal Circuit (addressed in Sections I and II, below).

2. **Unresolved Question.** Whether collateral estoppel should be applied to deny a taxpayer who raises an issue of law within any particular circuit of the same treatment afforded to all other taxpayers who raise the same issue within that circuit (addressed in Section III, below).

I. The Federal Circuit Erred by Disregarding the Factual Distinctions Between this Case and *Arkla I*

Although the Federal Circuit acknowledged at least the abstract relevance of *Sunnen* in the collateral estoppel analysis, it disregarded the *Sunnen* Court's fundamental holding that "if the relevant facts in the two cases are separable, even though they may be similar or identical, collateral estoppel does not govern the legal issues which recur in the second case." 333 U.S. at 601. Implicitly rejecting the continued viability of this critical holding of *Sunnen*, and relying on this Court's later decision in *Montana*, the appeals court concluded that the collateral estoppel analysis has evolved to preclude application of the doctrine only in circumstances where the facts of the case at hand are *materially* different from those which were at issue in the prior case upon which the estoppel is grounded.

After expressing its view of the doctrine's application in terms of materiality, the appeals court concluded, with respect to the Petitioner's *cushion gas*, that the differences between the facts at issue in the instant case and those at issue in *Arkla I* were not sufficiently material as to preclude application of collateral estoppel. The court considered as immaterial the fact that the cushion gas at issue in this case was placed in service in a different taxable year than was the cushion gas at issue in *Arkla I*. By dismissing this difference as lacking controlling significance, the Federal Circuit improperly rejected the continuing viability of the *Sunnen* separable facts analysis in the tax setting.

The court below also concluded that the Petitioner was collaterally estopped from arguing the substantive merits of its claim even with respect to the separate *line pack gas* issue, noting that the line pack gas employed in the Petitioner's pipeline system

is functionally equivalent to the cushion gas employed in its gas storage facility. The court completely ignored the facts that (1) the depreciable character of the Petitioner's line pack gas was not at issue in *Arkla I*, which involved only the proper characterization of cushion gas, and (2) cushion gas and line pack gas are entirely separate and wholly-unrelated assets. The appeals court thus completely disregarded the significant difference between the facts of this case and those of the case upon which its collateral estoppel determination was premised. The appeals court thus erred by attaching its opinion concerning the line pack issue as a mere appendage to the unrelated cushion gas issue.[6]

A. The *Sunnen* "Separable Facts" Analysis Applies in the Tax Setting Without Regard to Questions of "Materiality"

In support of its application of collateral estoppel in this case, the Federal Circuit relied in large part on this Court's holding in *Montana* for the proposition that the *Sunnen* decision rested upon the existence of a significant change in the controlling legal climate rather than the fact that the contracts there at issue constituted distinct contractual arrangements confected in different taxable years. A review of the post-*Montana* jurisprudence, however, as well as a considered reading of *Montana* itself, reveals that the appeals court improperly construed the case as affecting the continued viability of the *Sunnen* separable facts analysis in a typical tax setting such as that posed here.

---

[6]The Federal Circuit also erred as a procedural matter by its *sua sponte* holding that the Petitioner was collaterally estopped with respect to the line pack issue. It is clear from Rule 18(c) of the Rules of the United States Court of Federal Claims, in which the Petitioner's claim was filed, that collateral estoppel is an affirmative defense which must be raised in the answer. Although the Respondent raised this defense in its answer with respect to cushion gas, it did not assert collateral estoppel as a defense to the Petitioner's separate claim concerning line pack gas and never argued at the trial level or before the Federal Circuit that the Petitioner was collaterally estopped from litigating the line pack issue on the merits. The appeals court's *sua sponte* raising of collateral estoppel as a defense to the Petitioner's claim with respect to its line pack gas therefore was clearly erroneous.

First, this Court reaffirmed the continuing validity of the *Sunnen* analysis in *United States v. Stauffer Chemical Co.*, 464 U.S. 165, 104 S. Ct. 575, 78 L. Ed.2d 388 (1984), and *Hooven II*, both of which were rendered after the *Montana* decision. Although *Stauffer Chemical* was not a tax case, this Court's discourse on the doctrine of collateral estoppel nevertheless is quite instructive. While the majority of the *Stauffer Chemical* Court rejected the argument that "two cases presenting the same legal issues must arise from the very same facts or transaction before an estoppel can be applied," the court qualified its conclusion with a significant exception:

> Whatever applicability that interpretation may have in the tax context, see *Commissioner v. Sunnen*, ... (refusing to apply an estoppel when two tax cases presenting the same issue arose from "separable facts"), we reject its general applicability *outside of that context*. 464 U.S. at 172, n.5 (emphasis added).

Thus, although the *Stauffer Chemical* Court embraced the more liberal application of collateral estoppel in the context of cases outside of the tax area, it nevertheless expressly noted that the strict *Sunnen* separable facts analysis continues to restrict application of the doctrine in tax cases.

Moreover, this Court refused to apply collateral estoppel in *Hooven II*, a tax case decided shortly after *Stauffer Chemical*, under circumstances where the different taxable years at issue provided the only factual basis for the holding. The taxpayer in *Hooven II* was challenging the validity of an *ad valorem* tax which the State of Ohio sought to impose in one year with respect to certain property. Although the state previously had litigated and lost the issue with respect to identical property which it had sought to tax in prior years, the Court rejected the taxpayer's argument that the state was thereby collaterally estopped from again asserting the tax liability:

> It is true, of course, that the parties in *Hooven I* were the same parties as those before us in the present case. It is true that the property sought to be taxed for 1976 and 1977 identifies with the property sought to be taxed for 1938, 1939 and 1940 in *Hooven I.* And it is true that the tax involved the same Ohio nondiscriminatory *ad valorem* personal property tax. The parties, the tax, and the goods imported and their containers are the same.. . . Collateral estoppel concepts, therefore, might have an initial appeal.
>
> *The years involved in this tax case, however, are not the same tax years at issue in Hooven I. Because of this, Commissioner v. Sunnen, ... is pertinent and, indeed, is controlling.* 466 U.S. at 362. (emphasis added).

The result in *Hooven II* thus turned upon the factual distinction between the taxable years there at issue and the taxable years at issue in *Hooven I.*

In contrast with the analysis employed by this Court in *Sunnen* and *Hooven II*, the Federal Circuit applied collateral estoppel in this case without regard to the facts that (1) *Arkla I* did not involve the depreciable character of line pack gas, and (2) the assets at issue here were placed in service in a different taxable year than was the asset at issue in *Arkla I.* The Federal Circuit's opinion therefore is in direct conflict with the established holdings of this Court in *Sunnen* and *Hooven II.*

B. The *Montana* Holding is Inapposite to This Case

Not only did the Federal Circuit improperly rely upon this Court's holding in *Montana* for the proposition that the assets and taxable years at issue here and those at issue in *Arkla I* were not sufficiently different to preclude the application of collateral estoppel; the appeals court also failed to recognize that the

Montana case did not raise the same issues of tax equality which are presented in a tax setting such as this. The *Montana* decision therefore is inapposite to the collateral estoppel analysis which should prevail in this case.

While *Montana* involved the constitutionality of a narrowly-applied state tax levied on public contractors, the typical tax case which the *Sunnen* analysis was intended to address involves the construction or application of a broad-based tax to which a virtual universe of taxpayers may be subject. Such is the case at hand. The critical issue in this case deals with the proper characterization for tax depreciation purposes (as the salvage value of an asset or as an entirely separate and distinct asset) of the economically-recoverable portion, element, or value which an asset may have upon its abandonment or other disposition. The relevance of this fundamental issue is not limited to taxpayers who own fungible assets such as cushion gas and line pack gas; indeed, its relevance pervades the universe of taxpayers who own depreciable assets of any kind, ranging from office furniture to motor vehicles, from buildings to computers, and from line pack gas to cushion gas. Accordingly, the Federal Circuit improperly construed the *Montana* Court's rejection of the *Sunnen* separable facts analysis in one setting as a wholesale abandonment of the theory in the context in which it was developed.[7] In short, the *Montana* decision simply does not support the appeals court's conclusion that the facts at hand are so similar to those at issue in *Arkla I* as to permit application of collateral estoppel in this case.

---

[7]Yet other distinctions render *Montana* inapposite to this case. For example, the facts under consideration in *Montana* presented a threshold difficulty to the court's consideration of the *Sunnen* "separable facts" issue simply because the government failed to establish that different contractual provisions were at issue. *See* 440 U.S. at 159, n.7. Finally, *Montana* involved considerations of comity which prevail in federal/state adjudications but which are of no concern between the various circuits in the federal system. *See Allen v. McCurry*, 449 U.S. 90, at 95-96, 101 S.Ct. 441, 66 L.Ed.2d 308 (1980), and Justice White's concurrence in *Stauffer Chemical*, 464 U.S. at 176.

II. Because This Case Involves an Intervening Change in the Law, the Application of Collateral Estoppel Here Would Result in the Inequitable Administration of the Revenue Laws

Not only did the Federal Circuit err by disregarding the fact that this case involves different assets and different taxable years than those which were at issue in *Arkla I*. Yet another aspect of the *Sunnen* Court's analysis renders collateral estoppel inapplicable here: that the doctrine does not apply where there has been a change or development in the controlling legal principles, thereby ensuring the administration of the tax laws so as to accord the same treatment to different taxpayers within the same circuit. This conclusion finds support in *Montana*, in which this Court cited its earlier *Sunnen* decision for the proposition that collateral estoppel was not intended to apply where there has been a modification in controlling legal principles which could render a previous determination inconsistent with prevailing doctrine. Both the *Sunnen* and the *Montana* decisions emphasized that the principles underlying the doctrine's development simply do not support its application under circumstances which would result in the discriminatory application of the law. This Court also underscored the significance of an intervening change in the law in *Hooven II*:

> The years involved in this case ... are not the same tax years at issue in *Hooven I*. Because of this, *Commissioner v. Sunnen, supra*, is controlling. ... An earlier decision of the Board of Tax Appeals, involving the same facts, questions, and parties but different tax years, was held not to be conclusive under the doctrine of collateral estoppel because certain intervening decisions of this Court made manifest the error of the result that had been reached by the Board. 333 U.S. at 602-607, 92 L.Ed. 898, 68 S.Ct. 715. *The reason for not applying the collateral-estoppel doctrine in the present case is even stronger than that in Sunnen, for here the constitutional analysis of the earlier*

case is repudiated by this Court's intervening pronouncement. 466 U.S. at 362.

One finds in the facts posed here two different expressions of such a modification in the law as enunciated by this Court in *Montana* and *Hooven II*. First, the enactment of the very Code section under consideration in this case represents the most obvious form of modification in controlling legal principles which would render *Arkla I* inconsistent with prevailing doctrine. Section 168 of the Code, which for the first time authorized taxpayers to depreciate an asset's entire cost without regard to its salvage value, was effective only with respect to assets which were placed in service subsequent to the taxable year at issue in *Arkla I*. The construction of this provision of the law which is central to this case thus simply was not at issue in the case upon which the Federal Circuit based its collateral estoppel holding.

Further, a jurisprudential modification of the controlling legal principles occurred when the Fifth Circuit decided *Arkla I*. This modification is reflected in the inconsistency between the Fifth Circuit's decision in that case and the Claims Court's earlier decision in *Transwestern*. The error of the Federal Circuit's opinion becomes apparent when the posture of this case is viewed from this perspective.

Arkla I involved the question of whether the economically-recoverable volume of the Petitioner's cushion gas which was placed in service in 1980 was eligible for the investment tax credit. Because the credit was available only with respect to property "of a character subject to the allowance for depreciation," the issue in *Arkla I* turned upon the determination of whether the recoverable volume of the cushion gas there at issue constituted depreciable property. The *Arkla I* court rejected the Petitioner's argument that the recoverable volume of the cushion gas represented merely the salvage value of the cushion gas as a whole (a depreciable asset), and concluded instead that the recoverable and non-recoverable volumes of that gas constituted separate and distinct assets for depreciation purposes. The court thus determined that, since the recoverable volume of the cushion gas was not subject to wear and

tear, or to decay or decline from obsolescence, it did not constitute a depreciable asset and, accordingly, was not eligible for the investment tax credit.

The issue in *Transwestern* involved the question of whether line pack gas constituted inventory or property subject to the allowance for depreciation. (Line pack gas serves the same function in a gas pipeline as cushion gas serves in a gas storage facility.) The Claims Court in *Transwestern* rejected the government's argument that the line pack gas constituted inventory, and concluded in favor of the taxpayer that it was a capital asset subject to the allowance for depreciation. The court noted, however, that a portion of the line pack would be economically-recoverable upon abandonment of the pipeline system and, in contrast with the Fifth Circuit in *Arkla I*, equated this volume of the gas as the salvage value of the line pack as a whole. Accordingly, the *Transwestern* court reduced the *amount* of the depreciation deductions to reflect the fact that, to the extent of its economic-recoverability, the line pack gas had a salvage value.

The Claims Court thus reached a completely different result in *Transwestern* than did the Fifth Circuit in *Arkla I* with respect to the issues posed under prior law by the facts there under consideration. Also, by coincidence, Transwestern Pipeline Company's principal place of business happens to be located within the geographic boundaries of the Fifth Circuit's jurisdiction. This combination of facts makes for a most interesting hypothetical situation in terms of the application of collateral estoppel. Consider the following example.

Assume that, after having won the issue under consideration here in the Claims Court for one taxable year, Transwestern Pipeline Company were to bring suit either in the Tax Court or in the United States District Court on the identical issue for a subsequent year in which the Internal Revenue Service again raised the question. In those circumstances, the Respondent would, under the Federal Circuit's reasoning in this case, be collaterally estopped from litigating the case on its merits and, in effect, would lose by default. The prior holding of the Claims

Court (a member of the Federal Circuit) in *Transwestern* thus would preclude the Fifth Circuit from applying its own law to the contrary. (It is significant to note that the Respondent's arguments in this case relied upon *Arkla I* not only for purposes of its collateral estoppel argument, but also in support of its argument with respect to the *substance* of the Petitioner's claims). The application of collateral estoppel in such a setting would open the door for the very inequality in the administration of the tax laws between Transwestern Pipeline Company and other taxpayers (such as the Petitioner) who might bring suit against the Respondent with respect to the same issue within the confines of the Fifth Circuit's geographic realm. This would give rise to the very potential for the unequal application of the tax laws which the *Sunnen* analysis was intended to avoid. *See, e.g., Sunnen*, 333 U.S. at 599; *Hooven II*, 466 U.S. at 362, 363.

In light of the inequality which would result from the application of collateral estoppel in the setting hypothesized above, *Arkla I* should, in any proceeding brought by Transwestern Pipeline Company in the Fifth Circuit concerning the depreciation of line pack gas, be treated as such a modification in controlling legal principles as to preclude application of collateral estoppel. The natural corollary to this conclusion is equally compelling when the posture of the case is reversed, as in the case at hand. Just as the Respondent should be entitled to argue *Arkla I* as a substantive defense to the *Transwestern* issue if raised in any future action which Transwestern Pipeline Company may bring in the Fifth Circuit, so, too, should the Petitioner be allowed to argue *Transwestern* in support of any *Arkla I* issue presented in the Federal Circuit. This analysis not only would preserve the integrity and autonomy of each of the federal circuits by allowing them to apply their own law, but also would prevent any inequality between the treatment of taxpayers within any one circuit. Were collateral estoppel to be applied to preclude the Respondent from raising *Arkla I* as a substantive defense in such a setting, Transwestern Pipeline Company would receive preferential tax treatment in the Fifth Circuit. Conversely, should collateral estoppel be applied to prevent the Petitioner from arguing the *Transwestern* holding in the case at hand, the Petitioner would be

deprived of the benefit afforded every other taxpayer who seeks resolution in the Federal Circuit of the issues posed here. The *Sunnen* Court expressly repudiated the application of collateral estoppel in such a setting, however, emphasizing that "such consequences...are neither necessitated nor justified by the principle of collateral estoppel." 333 U.S. at 599. This analysis illustrates that treating *Arkla I* as such a change in controlling legal principles as to defeat the application of collateral estoppel in this case would comport with the *Montana* and *Hooven II* Courts' readings of *Sunnen*. Further, as noted below, this analysis also finds support in Justice White's concurring opinion in *Stauffer Chemical, supra.*

III. Collateral Estoppel Does Not Apply Where There Exists a Conflict Among the Circuits With Respect to the Substantive Merits of a Case

This Court concluded in the *Stauffer Chemical* case that collateral estoppel applied to prevent the government from relitigating in the Sixth Circuit the same issue which had been decided in favor of the defendant in the Tenth. The Sixth Circuit had not previously addressed the issue. Although the majority opinion did not address the issue of whether the government also would have been precluded from litigating the issue in the Ninth Circuit, where it had prevailed against another defendant, Justice White felt compelled to do so in his concurring opinion. Justice White's concurrence thus expressly addressed the issue presented in this case.

Justice White first noted his agreement with the majority that the defendant was protected from further litigation in the Tenth Circuit, which previously had rendered a decision in the defendant's favor. He also agreed that the defendant should not have to litigate the issue in the Sixth Circuit, which had not adopted a position on the merits. Justice White explained, however, that he would not apply collateral estoppel to preclude litigation of an issue where there exists a conflict among the circuits with respect to the substantive merits of the case.

Justice White began his concurrence by explaining that the policy concerns with inconsistent decisions are less relevant between circuits than within them. He also noted that conflicts between the circuits not only are accepted, but often are welcomed. *See* 464 U.S. at 177. Justice White then noted that collateral estoppel should protect a defendant from fighting in the various circuits in which it does business a battle which it had once won in another. He reasoned that preclusion would be justified in the circuit which previously decided the issue in the defendant's favor and in circuits which had not yet addressed the issue. *He concluded, however, that collateral estoppel should not apply to prevent litigation of the issue in a circuit which had rendered a contrary conclusion.*

In support of his conclusion that preclusion should not extend to prevent litigation of an issue in a circuit which previously had adopted a position contrary to that of another, Justice White noted that:

> Judicial economy is not served for the simple reason that no litigation is prevented; the prior litigant is subject to one black-letter rule rather than another. For the same reason, there is no concern about protecting the prior litigant from repetitious, vexatious, or harassing litigation. Finally, to the extent the policy against inconsistent decisions remains relevant when a circuit conflict exists, it cuts the other way. At least some measure of consistency and certainty is obtained by even-handed application of rules within individual circuits. 464 U.S. at 178.

He thus explained that application of the doctrine to such cases actually would cut against the policy reasons which support its application in other contexts, and he emphasized that the resulting inconsistency in fact would compound the problems presented by normal splits between the circuits. *See* 464 U.S. at 178, 179.

Justice White reasoned that the application of collateral estoppel to preclude litigation of an issue in a circuit which had adopted a position inconsistent with that of another would promote the unequal administration of the law. Where inconsistencies *between* circuits exist, they stimulate a full and complete debate of the law and thereby tend to enhance its development. This benefit would be outweighed by notions of simple fairness in the case of an inconsistency *within* a circuit, however, which would result in the court applying the law in one fashion with respect to one citizen but in a different fashion with respect to another. According to Justice White:

> This confusing state of affairs far exceeds in awkwardness a normal split in the circuits. ... In general, persons present in several circuits must conduct themselves in accordance with varying rules, just as they are subject to different state laws. ... A split in the circuits cannot justify abandonment of all efforts at even-handed and rational application of legal rules. 464 U.S. at 179.

Justice White also reasoned that relitigation of an issue should not be precluded if the issue is one of law and a new determination is warranted to implement an intervening change in the law or to avoid inequitable administration of the law. He noted that both of these elements apply to permit litigation of an issue in one circuit where the prevailing legal analysis differs from that previously established by another. Justice White thus equated a conflict of law between circuits as an intervening change of law within a circuit. *See* 464 U.S. at 180, 181, n.1.

Finally, Justice White emphasized that, while collateral estoppel was designed to ensure litigants the benefit of prior *litigation*, the doctrine was *not* intended to ensure them the benefit of a prior *ruling*. *See* 464 U.S. at 181. He thus drew a distinction between operation of the doctrine in order to prevent relitigation of *how the law ought to be applied to particular facts* and its operation to prevent later arguments concerning the validity of a

legal concept as an *abstract proposition of law*. While the doctrine embraces the former as a means of protecting litigants from the expense of repetitious lawsuits, it repudiates the latter as an impediment to the thorough discourse which is essential to the full development of the law.

Justice White's concurrence thus addressed the issue which was left unanswered in the *Stauffer Chemical* Court's majority opinion but which is posed in this case. Under his analysis, the policy reasons underlying the doctrine of collateral estoppel would not support its application to preclude the Petitioner from litigating the substantive issues posed here because the Claims Court, a member of the Federal Circuit, adopted in *Transwestern* a rule of law different from that expressed by the Fifth Circuit in *Arkla I*.

CONCLUSION

This Court has recognized that the doctrine of collateral estoppel was developed to "...relieve parties of the cost and vexation of multiple lawsuits, conserve judicial resources, and, by preventing inconsistent decisions, encourage reliance on adjudication." *Allen v. McCurry*, 449 U.S. 90, at 94, 101 S.Ct. 441, 66 L.Ed.2d 308 (1980). None of these purposes would be advanced by extending preclusion to this case. First, where one of the parties is the United States and the issue involves the interpretation of a provision of the tax law which affects literally millions of taxpayers, the goal of judicial economy simply is not advanced. Any one of those taxpayers can force a ruling on the merits at any time. The Federal Circuit's opinion thus, by concluding that the Petitioner is precluded from litigating the substance of the issues posed here, in effect would provide the Respondent with immunity from a rule of law rather than immunity from further litigation. As Justice White noted in his concurring opinion in *Stauffer Chemical*, however, a litigant is entitled only to the benefit of prior *litigation*; he is *not* entitled to the benefit of a prior *ruling*. *See* 464 U.S. at 181. Thus, while the parties to prior litigation may be bound by the *application* of a legal principle in a prior setting, they are not thereby precluded

from arguing in a later proceeding that, as an abstract proposition of law, the rule should be otherwise. *See* 464 U.S. at 181, n.2.

Nor would the application of collateral estoppel in this case further the policy objective of preventing inconsistent decisions as a means of encouraging reliance upon adjudication. To the contrary, the application of collateral estoppel in this case would in effect *create* an inconsistency *within the Federal Circuit* by denying the Petitioner the relief afforded other taxpayers within that circuit under the holding of *Transwestern*. The Federal Circuit's opinion thus would result in the very inequality and discriminatory application of the tax laws which this Court expressly rejected in *Sunnen*, *Montana* and *Hooven II*.

If left standing, the Federal Circuit's decision will place the Petitioner at a competitive disadvantage with other interstate pipeline companies who, in reliance upon the *Transwestern* decision, would be able to depreciate the entire cost of their line pack gas and cushion gas placed in service after the effective date of Section 168 of the Code (including the economically-recoverable volumes or salvage values of those assets). The Petitioner, on the other hand, would be perpetually barred from the tax benefit envisioned by Congress in its adoption of Section 168, which provides for the recovery of the entire cost of any asset placed in service after 1980 without regard to its salvage value. As a result, the Petitioner would suffer a distinct competitive disadvantage in relation to other pipeline companies who could charge less for their gas and/or transportation services because of the tax benefit they received under Section 168. This result would be in direct conflict with this Court's repeated admonitions in *Sunnen* and *Hooven II* - that collateral estoppel is not to be blindly applied where an intervening change in the controlling legal principles would result in the inequitable administration of the revenue laws.

In summary, the Federal Circuit erred when it applied collateral estoppel to preclude the Petitioner from litigating its entitlement to ACRS deductions and the investment tax credit with respect to its recoverable line pack gas, an issue *never* considered

in the *Arkla I* decision. The Federal Circuit further erred in its application of collateral estoppel to preclude the Petitioner from litigating its entitlement to ACRS deductions and investment tax credits with respect to both line pack gas and cushion gas placed in service in a year *subsequent* to that at issue in *Arkla I* and *subsequent* to a change in controlling legal principles. Such errors seriously undermine this Court's holdings in *Sunnen* and *Hooven II*. Finally, the Federal Circuit erred in barring the Petitioner from seeking the same tax treatment as afforded other taxpayers within the scope of its jurisdiction. Accordingly, this Court should grant a writ of certiorari to reverse these errors by upholding the continued validity of its *Sunnen* and *Hooven II* decisions, and to address directly the issue raised by Justice White in *Stauffer Chemical*.

Respectfully submitted,

LAWRENCE L. JONES
Counsel of Record
J. EDGERTON PIERSON, JR.
BLANCHARD, WALKER, O'QUIN & ROBERTS
(A Professional Law Corporation)
1400 Premier Bank Tower
Shreveport, Louisiana 71101
(318)221-6858

FREDERICK R. PARKER, JR.
Beck Building
400 Travis Street
Shreveport, Louisiana 71101
(318)221-4396

Counsel for Petitioner

APPENDICES

APPENDICES

		Page
APPENDIX A	Opinion of the Federal Court of Appeals for the Federal Circuit (October 4, 1994)	1a
APPENDIX B	Opinion of the United States Court of Federal Claims (December 3, 1992)	15a
APPENDIX C	Opinion of the United States Court of Federal Claims (September 13, 1993)	33a
APPENDIX D	Statutory and Regulatory Provisions Involved	39a

APPENDIX A

United States Court of Appeals for the Federal Circuit

94-5023

ARKLA, INC.,

Plaintiff-Appellant,

v.

THE UNITED STATES,

Defendant-Appellee.

Lawrence L. Jones, Attorney, Blanchard, Walker, O'Quin & Roberts, of Shreveport, Louisiana, argued for appellant. Of counsel were J. Edgerton Pierson, Jr. and Frederick R. Parker, Jr.

Thomas J. Clark, Attorney, United States Department of Justice, of Washington, D.C., argued for appellee. With him on the brief were Loretta C. Argrett, Acting Assistant Attorney General,
Gary R. Allen and Jonathan S. Cohen.

Appealed from: United States Court of Federal Claims J. Harkins

94-5023

ARKLA, INC.,

Plaintiff-Appellant,

v.

THE UNITED STATES,

Defendant-Appellee.

DECIDED: October 4, 1994

Before MAYER, MICHEL and LOURIE, Circuit Judges.
MICHEL, Circuit Judge.

Arkla, Inc. appeals the Court of Federal Claims' grant of summary judgment for the government, denying Arkla's claim for income tax refunds in two related cases, Arkla, Inc. v. United States, 27 Fed. Cl. 226 (1992) (Arkla II), and Docket No. 90-3954T, decided September 13, 1993. Arkla claimed refunds for taxes and assessed interest paid for the years 1981 through 1984 based on the Internal Revenue Service's (IRS) denial of an investment tax credit (ITC) under I.R.C. (26 U.S.C.) § 38[1] and depreciation deductions under I.R.C. § 168 for recoverable cushion gas and line pack gas purchased for Arkla's natural gas facilities. Because Arkla is collaterally estopped from bringing these claims

---

[1]Unless otherwise noted, all statutory references are to the Internal Revenue Code, as in effect during the years at issue in this case, 1981 through 1984.

by a Fifth Circuit decision, Arkla, Inc. v. United States, 765 F.2d 487 (5th Cir. 1985) (Arkla I), we affirm.

BACKGROUND

A. Cushion Gas

Arkla is an integrated natural gas company providing natural gas to customers in Arkansas, Louisiana, Kansas, Oklahoma, and Texas. In the late 1970's, Arkla purchased the right to store gas in the Chiles Dome reservoir, a natural underground gas reservoir in Oklahoma, as well as surface rights for drilling wells, laying pipelines, and constructing other facilities. Arkla determined that in order to efficiently deliver gas from the reservoir to its customers, the reservoir must always contain 14 BCF (billion cubic feet) of "cushion gas," a volume of natural gas required to maintain a desired minimum pressure for a gas storage facility.

The cushion gas was the largest single item of cost in the construction of the Chiles Dome reservoir, costing almost $18 million. In 1980 Arkla purchased, at a total cost of approximately $10 million, 3.5 BCF of native natural gas already in the reservoir and 5.98 BCF of natural gas which was injected into the reservoir to serve as cushion gas. A majority of this gas was classified for Federal Energy Regulatory Commission (FERC) accounting purposes as recoverable and the remainder was classified as nonrecoverable. Recoverable cushion gas can be economically withdrawn from the reservoir and sold upon abandonment of the facility, although both recoverable and nonrecoverable cushion gas serve the same function in operating a gas storage facility. In 1981, Arkla purchased additional natural gas costing over $8 million and injected it into the reservoir to serve as cushion gas. All of the gas purchased in 1981 was classified as recoverable.

On its 1980 federal income tax return, Arkla claimed an investment tax credit (ITC) under section 38 of the Internal Revenue Code, for the cost of the nonrecoverable cushion gas. The IRS allowed the credit. Arkla then filed an amended return

for 1980 claiming an additional ITC for the cost of the recoverable cushion gas. When the IRS neither allowed nor disallowed this claim within six months after the amended return was filed, Arkla sought a refund in the United States District Court for the Western District of Louisiana. The district court granted summary judgment for Arkla, which was reversed by the Fifth Circuit in Arkla I, 765 F.2d at 487.

The Fifth Circuit concluded that to qualify for an investment tax credit, cushion gas must be a capital asset, depreciable, and have useful life over three years under I.R.C. § 48(a) (1). Id. 489. The court held that the recoverable cushion gas was not depreciable because it would remain physically unchanged in the reservoir for an indefinite period of time and could be sold when the reservoir was finally closed. Id. at 490.

On its income tax return for 1981, Arkla claimed an ITC of $944,690.32 under I.R.C. § 38 for the cushion gas purchased in 1981 and a depreciation deduction of $657,175.95 for that gas under the Accelerated Cost Recovery System (ACRS) provision of I.R.C. § 168. Arkla also claimed depreciation deductions in the amounts of $1,150,057.91, $985,763.93 and $821,469.94 on its tax returns filed for the years 1982, 1983 and 1984, respectively.

The IRS disallowed the investment tax credit claimed in 1981 and depreciation deductions claimed for 1981-84. Arkla prepaid the asserted deficiencies and sought a refund in the Court of Federal Claims which granted summary judgment for the government, holding that Arkla I collaterally estopped Arkla from arguing that it is entitled to an ITC and depreciation deductions for recoverable cushion gas. Arkla II, 27 Fed. Cl. at 233.

B. Line Pack Gas

Arkla also seeks an income tax refund based on the IRS's denial of an ITC for 1981 and of depreciation deductions for the years 1981-84 for gas purchased to be used as line pack gas in Arkla's natural gas pipeline system. Line pack gas is the amount

of gas which must remain in the pipelines at all times to maintain a certain pressure for efficient use.

The parties stipulated that in 1981 Arkla injected 18,532 MCF (thousand cubic feet) into the pipeline system, of which 70% is economically recoverable. The Court of Federal Claims granted summary judgment in part for the government and in part for Arkla, holding that Arkla could recover an ITC and depreciation deductions only for the portion of the line pack gas that is not recoverable. Arkla appealed both rulings favorable to the government, arguing it should receive an ITC and depreciation deductions for the entire volume of the cushion gas and the line pack gas. We have jurisdiction pursuant to 28 U.S.C. § 1295(a)(3) (1988).

STANDARD OF REVIEW

Because the Court of Federal Claims denied Arkla's request for tax refunds as a matter of law by granting the government's motions for summary judgment, our standard of review is de novo. Turner v. United States, 901 F.2d 1093, 1095 (Fed. Cir. 1990) ("We review the grant of summary judgment motions by the Claims Court de novo.").

ANALYSIS

A. Collateral Estoppel Bars Arkla's Claim Based on the Cushion Gas

The doctrine of collateral estoppel, also called issue preclusion, bars parties to a prior lawsuit from relitigating any issues that were actually and necessarily determined by a court of competent jurisdiction in the prior suit. Parklane Hosiery Co., Inc. v. Shore, 439 U.S. 322, 326 n.5 (1979). The doctrine serves "the dual purpose of protecting litigants from the burden of relitigating an identical issue with the same party or his privy and of promoting judicial economy by preventing needless litigation." Id. at 326. Affording a litigant more than one full and fair opportunity for judicial resolution of the same issue results in an untenable

misallocation of resources. Blonder-Tongue Labs., Inc. v. University of Ill. Found., 402 U.S. 313, 328-29 (1971).

Collateral estoppel is appropriate only if: (1) the issue to be decided is identical to one decided in the first action; (2) the issue was actually litigated in the first action; (3) resolution of the issue was essential to a final judgment in the first action; and (4) the parties had a full and fair opportunity to litigate the issue in the first action. Mother's Restaurant, Inc. v. Mama's Pizza, Inc., 723 F.2d 1566, 1569, 221 USPQ 394, 397 (Fed. Cir. 1983).

1. The Issue Presented by This Case

Because Arkla argues that only the requirement of identical issues has not been met here, our first task is to define the issue in this case. To be eligible for an ITC under section 38, the property in question must be either "recovery property" or "property with respect to which depreciation . . . is allowable." I.R.C. § 48(a).[2] To be eligible for a depreciation deduction through the ARCS provision of section 168, the property in question must be "recovery property," I.R.C. § 168(a), which section 168(c)(1) defines as "tangible property of a character subject to the allowance for depreciation."[3] Although neither section 48

---

[2]The relevant portion of section 48(a) defines "section 38 property" as including:

> only recovery property (within the meaning of section 168 without regard to any useful life) and any other property with respect to which depreciation (or amortization in lieu of depreciation) is allowable and having a useful life (determined as of the time such property is placed in service) of 3 years or more.

I.R.C. § 48(a).

[3]Section 168(c)(1) defines "recovery property":

> (c) Except as provided in subsection (e) [referring to property placed in service before Jan. 1, 1981], the term "recovery property" means

nor section 168 provides a definition of "depreciation," section 167(a) describes property for which a depreciation deduction is allowed:

> There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)--
>
> (1) of property used in the trade or business, or
>
> (2) of property held for the production of income.

I.R.C. § 167(a).

Thus, whether Arkla is entitled to an ITC and depreciation deductions for the recoverable cushion gas injected into the reservoir in 1981 depends on whether recoverable cushion gas is "property with respect to which depreciation . . . is allowable," I.R.C. § 48(a), and similarly, "property of a character subject to the allowance for depreciation," I.R.C. § 168(c). This question turns on whether recoverable cushion gas is property subject to "exhaustion, wear and tear (including . . . obsolescence)." I.R.C. § 167(a).

2. The Issue Decided in Arkla I

The issue presented by this case is identical to that decided in Arkla I. The Fifth Circuit described "the sole issue" in Arkla I as "Arkla's eligibility for the investment tax credit with respect to the recoverable cushion gas. Resolution of this issue depend[s]

> tangible property of a character subject to the allowance for depreciation (A) used in a trade or business, or (B) held for the production of income.

I.R.C. § 168 (c)(1).

upon whether such gas constitutes depreciable property." Arkla I, 765 F.2d at 488-89.

In Arkla I the Fifth Circuit concluded that recoverable cushion gas must be treated as non-depreciable property even though it is physically identical to nonrecoverable cushion gas which is treated as depreciable property:

> [T]he recoverable cushion gas will remain physically unchanged in the storage facility for an indefinite period of time. At any time that the storage facility is closed, the recoverable gas, by definition, will be available for sale or other use, with its general utility and value undiminished in any fashion. That the nonrecoverable cushion gas will become obsolete along with the storage facility, while the recoverable cushion gas will not, mandates a different treatment of the two assets for depreciation purposes.

Id. at 490. Cushion gas does not decay or deteriorate. It becomes obsolete only if it cannot be recovered from an abandoned storage facility. Thus, the Fifth Circuit held that recoverable cushion gag is a separate asset from nonrecoverable cushion gas. The Fifth Circuit further held that recoverable cushion gas is not eligible for an ITC because it is not depreciable and, therefore, not "section 38 property" under section 48(a) (1). Id.

In both Arkla I and this case, Arkla's entitlement to a refund turns on whether recoverable cushion gas is subject to depreciation as defined by section 167(a). Thus, the "question expressly and definitely presented in this suit is the same as that definitely and actually litigated and adjudged" adversely to Arkla in the Fifth Circuit. United States v. Moser, 266 U.S. 236, 242 (1924). Absent significant changes in controlling facts or legal principles since Arkla I, or other special circumstances, the Fifth Circuit's resolution of these issues is conclusive here. Commissioner v. Sunnen, 333 U.S. 591, 599 (1948) ("[A] subsequent modification of the significant facts or a change or

development in the controlling legal principles may make that determination obsolete or erroneous, at least for future purposes.").

a. No Material Facts Have Changed

Arkla argues that the issue in this case is not identical to the issue decided in Arkla I because Arkla I involved the availability of an ITC for cushion gas purchased in 1980, whereas this case involves the availability of a depreciation deduction and an ITC for cushion gas purchased in 1981.[4]

Factual differences must be material, i.e., having legal significance, to prevent operation of collateral estoppel. Montana v. United States, 440 U.S. 147, 162 (1979). In Montana, a contractor on a federal dam project brought a lawsuit in state court which was directed and financed by the federal government to challenge the constitutionality of a Montana tax imposed on public, but not private, contractors. The state court upheld the constitutionality of the tax. Id. at 151. The federal government then brought a separate suit challenging the same tax in the United States district court. However, the government's suit placed in issue contracts different from those at issue in the first case. The Supreme Court held that the government's suit was barred by collateral estoppel because the different contract provisions did not raise "material" differences in facts that were essential to the state court's judgment. Id. at 159-60.

The additional depreciation deduction and the different purchase years present in this case are not material differences of controlling significance. The fact that Arkla claims a depreciation deduction here, whereas it only claimed an ITC in Arkla I, is not

---

[4]Arkla relies on Commissioner v. Sunnen, 333 U.S. 591 (1948), for the proposition that collateral estoppel applies in tax cases only when relevant facts are unchanged. However, in Montana v. United States, 440 U.S. 147 (1979), the Court distinguished Sunnen, explaining that collateral estoppel did not apply in that case because "there had been a significant change in the legal climate." Id. at 161, quoting Sunnen, 333 U.S. at 606. Thus, the factual changes in Sunnen were not the basis of the holding in that case.

material because Arkla's entitlement to the depreciation deduction turns on the same issue as its entitlement to the ITC--whether recoverable cushion gas is subject to depreciation as defined in section 167(a). Likewise, the fact that the cushion gas of Arkla I was purchased in 1980 and the cushion gas here was purchased in 1981 is not material because it has no bearing on the dispositive issue of whether the recoverable cushion gas is depreciable. The facts essential to the judgment in Arkla I were that recoverable cushion gas is not subject to exhaustion, wear and tear or obsolescence, and that at the time the Chiles Dome facility would be closed, the recoverable cushion gas would be available for sale. Thus, because neither factual difference in this case alters any of these facts essential to the judgment in Arkla I, the differences do not prevent operation of collateral estoppel in this case.

b. The Relevant Law Has Not Changed

Arkla also argues that a change in the controlling legal principles after 1980 renders Arkla I inconsistent with the statutes governing this case, precluding application of collateral estoppel. Enactment of the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172, added section 168(f)(9) to the Internal Revenue Code. That section states, "[n]o salvage value shall be taken into account in determining the deduction allowable under subsection (a)." I.R.C. § 168(f) (9). Section 168(f)(9) provides that salvage value is irrelevant when determining the amount of depreciation deduction available with respect to assets placed in service after 1980.

Section 168(f)(9) does not affect the law relevant to the determination made in Arkla I, that recoverable cushion gas, an asset separate from nonrecoverable gas, is not depreciable under section 167 because it is not subject to exhaustion, wear and tear or obsolescence. Section 168(f)(9) only affects the amount of a depreciation deduction once an asset is found to be subject to depreciation. Salvage value does not influence whether a depreciation deduction is allowed in the first place, which is the issue both here and in Arkla I. Thus, the controlling law is identical in Arkla I and this case.

Arkla argues that section 168(f)(9) in combination with the holding in Transwestern Pipeline Co. v. United States, 639 F.2d 679, 225 Ct. Cl. 999 (1980), changes the controlling legal principles from those applied in Arkla I. Arkla contends Transwestern holds that line pack gas, which is functionally equivalent to cushion gas, must be treated as a single asset, with the recoverable line pack gas representing merely the salvage value of the single asset. According to Arkla, because Transwestern holds that line pack gas must be treated as a single asset, cushion gas must also be treated as a single asset, with the value of recoverable cushion gas being the salvage value of the entire asset. Arkla further contends that because salvage value cannot be taken into account under section 168(f) (9) when determining the amount of a depreciation deduction, the value of the recoverable cushion gas cannot be taken into account when determining the depreciation deduction for the entire amount of cushion gas.

Without commenting on whether Arkla's characterization of Transwestern is correct, we note that it is central to Arkla's argument that we treat cushion gas as a single asset rather than treating recoverable cushion gas as a separate asset from nonrecoverable cushion gas. Arkla is collaterally estopped by Arkla I from arguing that cushion gas is one asset because Arkla I expressly held that recoverable cushion gas is a separate asset from nonrecoverable cushion gas. 765 F.2d at 490 ("That the nonrecoverable cushion gas will become obsolete along with the storage facility, while the recoverable cushion gas will not, mandates a different treatment of the two assets for depreciation purposes.").

Arkla argues that we may not follow the rationale of Arkla I, but instead must follow the rationale of Transwestern in deciding whether to treat recoverable gas as a separate asset or as the salvage value of the entire volume of cushion gas because Transwestern is a binding precedent on this court. South Corp. v. United States 690 F.2d 1368, 1370 (Fed. Cir. 1982).

Whether we or our predecessor court would have decided Arkla I differently had it been brought here is irrelevant to the

issue of collateral estoppel before us now. The court that considers the question of collateral estoppel does not examine the reasoning of the court that decided the issue. University of Ill. Found. v. Blonder-Tongue Labs., Inc., 465 F.2d 380, 381 (7th Cir.), cert. denied, 409 U.S. 1061 (1972). "Collateral estoppel does not turn upon a determination that a prior ruling was correctly rendered . . . ." Laaman v. United States, 973 F.2d 107, 112 (2nd Cir. 1992) (emphasis in original), cert. denied, 113 S.Ct. 1368 (1993). Because the treatment of recoverable cushion gas as a separate asset was essential to the Fifth Circuit's ruling in Arkla I, Arkla is estopped from obtaining any different treatment of recoverable cushion gas now. Arkla does not contest that it had a full and fair opportunity to litigate that issue in the Fifth Circuit, so we will not consider the issue here. Moreover, as explained above, once recoverable cushion gas is viewed as a separate asset, section 168(f) (9) is irrelevant in determining whether it is depreciable. Thus, no change in the controlling legal principles precludes the application of collateral estoppel in this case and the Fifth Circuit's resolution of these issues is conclusive here.

B. Collateral Estoppel Bars Arkla's Claim Based on Line Pack Gas

We hold that Arkla is also collaterally estopped by Arkla I from arguing that the recoverable line pack gas which it purchased in 1981 is entitled to an ITC and a depreciation deduction. question in Arkla I. Whether recoverable cushion gas is depreciable, is identical to the question hire, whether recoverable line pack gas is depreciable, when nonmaterial facts are taken into account. Because the differences between cushion gas and line pack gas do not amount to differences having controlling significance, the issue concerning the depreciability of recoverable gas is the same in both cases.

In arguing that Transwestern controls the outcome of its claims based on cushion gas, Arkla asserts that line-pack gas is functionally equivalent to cushion gas. Although we disagree with Arkla's analysis of the import of Transwestern, we do acknowledge that line pack gas is functionally equivalent to cushion gas. Line pack gas, like cushion gas, is an amount of gas that must be

maintained in the gas facilities to maintain a certain pressure for efficient use. Recoverable line pack gas, like recoverable cushion gas, is not subject to exhaustion, wear and tear or obsolescence. Both recoverable line pack and cushion gas can be removed from the facility and sold when the facility is abandoned. The analysis which led the Fifth Circuit to hold that recoverable cushion gas is not depreciable in Arkla I applies identically to recoverable line pack gas.

Therefore, we hold that the rule of Arkla I must be applied to line pack gas also because the difference between line pack gas and cushion gas does not amount to a material fact that would preclude application of collateral estoppel. We require that the tax liability for recoverable line pack gas and cushion gas be identical because we see no principled reason to treat them differently. For these reasons, Arkla is collaterally estopped from arguing that recoverable line pack gas is entitled to an ITC and depreciation deductions.

CONCLUSION

In both Arkla I and this case, Arkla's entitlement to a refund turns on whether recoverable gas is subject to depreciation as defined by section 167(a). Because both cases involve the identical issue, and the controlling facts and law have not changed, Arkla is collaterally estopped from bringing the present suit. Arkla had the choice of bringing its initial suit for a refund in either the former Claims Court,[5] from which an appeal to this court lies, or the District Court for the Western District of Louisiana, from which Arkla I was appealed to the Fifth Circuit. See 28 U.S.C. § 1346(a)(1) (1988 & Supp. V 1993). Arkla chose to litigate this issue in the district court and is now bound by the outcome of that litigation. Having received an unfavorable outcome, Arkla cannot simply "try again" in the Court of Federal Claims. By precluding

[5]As of October 29, 1992, the United States Claims Court became the United States Court of Federal Claims, pursuant to Title IX of the Federal Courts Administration Act of 1992, Pub. L. No. 102-572, 106 Stat. 4506.

Arkla from contesting matters that it has had a full and fair opportunity to litigate, we protect its adversary, the IRS, from the expense and vexation attending multiple lawsuits, conserve judicial resources, and foster alliance on judicial action by minimizing the possibility of inconsistent decisions. See Montana, 440 U.S. at 153-54. Were we to allow Arkla to relitigate this issue and decide it differently from the Fifth Circuit, as Arkla asks, we would create an untenable situation. A single taxpayer would be bound by two conflicting rules and the IRS would have no way of knowing which rule to apply prospectively. Clearly, such a situation cannot be tolerated. For these reasons, both decisions of the Court of Federal Claims are

AFFIRMED.

COSTS

Arkla shall bear all costs.

APPENDIX B

No. 90-3954T

(Filed: December 3, 1992)

* * * * * * * * * * * * * * * * * *

ARKLA, INC.

Plaintiff,

v.

THE UNITED STATES,

Defendant.

Income Tax; Investment Tax Credit; Accelerated Cost Recovery System; Recovery Property; Recoverable Cushion Gas; 26 U.S.C. §§ 38, 48, 167 & 168

* * * * * * * * * * * * * * * * * *

Lawrence L. Jones, Shreveport, Lousiana, attorney of record for plaintiff. J. Edgerton Pierson, Jr., Frederick R. Parker, Jr., and Blanchard, Walker, O'Quin & Roberts, of counsel.

Kenneth C. Gobetz, Washington, D.C., with whom was Assistant Attorney General Stuart M. Gerson, for defendant.

- - - - - - - - - -

- - - - - - - - - -

In its complaint filed November 16, 1990, Arkla, Inc., claimed income tax refunds, and assessed interest, in total amount of $2,615,363.23 paid with respect to taxable years 1981, 1982, 1983, and 1984. Plaintiff's claims are based on alleged wrongful denials by the IRS of entitlements to deductions for recovery property under 26 U.S.C. § 168, and denial of entitlement to investment tax credit under 26 U.S.C. § 38. The recovery property concerns purchases of natural gas in 1981 for use as "cushion gas" in plaintiff's Chiles Dome gas storage facility; tax years 1982,

1983 and 1984 are in suit as a result of the continuation of plaintiff's claimed deductions for "cushion gas" purchased in 1981.

In its answer, defendant asserted collateral estoppel as an affirmative defense to the claims for refunds related to investment tax credit and depreciation for cushion gas injected in the Chiles Dome storage facility. Defendant's collateral estoppel argument is based upon the decision of the Fifth Circuit on plaintiff's claims for refunds for investment tax credit for purchases of "cushion gas" in 1980. Arkla, Inc. v. United States, 765 F. 2d 487 (5th Cir. 1985), cert. denied, 475 U.S. 1064 (1986) (Arkla I). The Fifth Circuit held that the portion of cushion gas that was recoverable was not subject to depreciation and that Arkla was not entitled to investment tax credit for the recoverable cushion gas.

The case came before the court for argument on November 24, 1992, on cross-motions for partial summary judgment, based on stipulated facts. At the close of argument, defendant's motion for partial summary judgment was allowed and plaintiff's cross-motion for partial summary judgment was denied.

Pursuant to RCFC 56(d), the parties in this case filed proposed findings of uncontroverted fact that essentially are restatements of the facts which were stipulated in the 1980 litigation in Civil Action No. 82-2437 in the District Court for the Western District of Louisiana. Plaintiff's proposed findings of fact are those found by the District Court in its Memorandum Ruling dated August 6, 1984. Defendant's proposed findings of fact consist of a repetition of the factual context as described by the Fifty Circuit in the appeal.

The Memorandum Ruling of the District Court contained definitions of relevant terms that had been stipulated by the parties. These definitions included:

> 1. "Cushion gas" is a natural gas contained in a gas storage facility which provides a minimum pressure for the facility. This gas is sometimes referred to in the gas industry as "base gas." In Arkla I, the Fifth Circuit added

the following supplement: "Cushion gas is physically indistinguishable from the natural gas delivered to customers; the term simply refers to the volume of gas required to maintain the desired pressure in the reservoir." 765 F.2d at 488.

2. "Working gas" is a natural gas contained in a gas storage facility which is stored for delivery into a gas transmission system at times of high demand, principally during the winter heating season, and which will be replaced at times of low demand, principally during the summer season. This gas is sometimes referred to in the gas industry as "top gas."

3. "Native gas" is natural gas contained in a gas storage facility which was present in an underground reservoir at the time such reservoir was acquired or converted for use as a part of a gas storage facility.

4. "Injected gas" is natural gas contained in a gas storage facility which has been injected into the facility from some outside source.

5. "Non-recoverable gas" is natural gas contained in a gas reservoir which cannot be economically withdrawn.

The record contains in a large volume of facts the parties have stipulated which need not now be reiterated. For disposition of the cross-motions, salient facts are summarized in the following description.

Arkla, Inc. is an integrated natural gas company, within the meaning of the Natural Gas Act, subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC"). Plaintiff provides gas service to more than 650,000 customers in its five state service area of Arkansas, Kansas, Louisiana, Oklahoma, and Texas. In 1976, plaintiff made an extensive reevaluation and update of its gas storage needs, and in January 1977, engaged the services of Keplinger and Associates, Inc., Tulsa, Oklahoma, to

assist with the search and evaluation of the potential gas storage prospects.

Keplinger's recommended plan to meet Arkla's storage goals included the purchase of the Chiles Dome reservoir, a natural underground gas reservoir in Eastern Oklahoma, and the construction and development of a gas storage facility to be connected with Arkla's existing transmission system. To this end, Arkla acquired from the surface owners the right to store gas in the formation, as well as surface rights for drilling wells, laying pipelines, and constructing gathering and transmission facilities.

Prior to its filings with FERC and the Oklahoma Corporation Commission, plaintiff had prepared extensive studies to determine the most economical method of constructing the gas storage facility within the parameters of approximately 11.5 to 12 BCF of working gas, minimum daily deliverability of 125 MMCF and at least a pressure of 610 pounds per square inch, for injection into plaintiff's transmission line. Those studies showed, as refined to the date of filing with the FERC for its certification, that the lowest cost of service per MCF was obtained by the utilization of an average minimum wellhead flowing pressure of 355 psig, which required 14 BCF of cushion gas for the flow rates involved, and the availability of 6,750 horsepower of surface compression.

The largest single item of cost for the construction of the Chiles Dome gas storage facility, regardless of the wellhead pressure considered, was the cushion gas. In its final design, the Chiles Dome gas storage facility was to store 12 BCF of working gas with minimum daily deliverability of 133 MMCF to provide for approximately 90 days of peak demand.

On August 7, 1980, plaintiff notified FERC that construction of the Chiles Dome gas storage facility was completed on July 30, 1980, and placed in service on that date for the initial injection into the gas storage facility. During calendar year 1980, plaintiff purchased at a cost of $9,689,239.16 and injected into the Chiles Dome 5.98 BCF of cushion gas as part of that storage

facility, and purchased at a cost of $328,305.20 the 3.5 BCF of native gas remaining in the storage reservoir.

The 5.98 BCF of cushion gas purchased and injected into Chiles Dome by plaintiff during 1980 is classified for FERC accounting purposes as recoverable cushion gas and, pursuant to the FERC Uniform System of Accounts, the $9,689,239.16 cost thereof is included in FERC Account #117 -- Gas Stored Underground-Noncurrent, which is one of the "Utility Plant" accounts.

The 3.5 BCF of native gas remaining in Chiles Dome and purchased by plaintiff in 1980 was classified for FERC accounting purposes as consisting of 512,774 MCF of recoverable native gas and 2,986,607 MCF of non-recoverable native gas. The $134,642.29 cost of the recoverable native gas is included in FERC Account #117 -- Gas Stored Underground-Noncurrent and the $193,662.91 cost of the non-recoverable native gas is included in FERC Account #352.3 -- Non-Recoverable Gas, which account is also one of the "Utility Plant" accounts.

During the year 1981, plaintiff invested $8,349,341.67 in natural gas which was injected into the Chiles Dome gas storage facility to serve as cushion gas. As employees of the plaintiff's tax department made some incorrect assumptions with regard to gas accounting data pertaining to this cushion gas, plaintiff, for purposes of calculating the investment tax credit and cost recovery deductions, used only the amount of $8,214,699.38 as the cost of the cushion gas purchased and injected in 1981. The cushion gas acquired in 1981 was classified as recoverable cushion gas for FERC accounting purposes.

The cushion gas (both recoverable and non-recoverable) is an integral part of the Chiles Dome gas storage facility and is classified pursuant to the FERC Uniform System of Accounts as part of "Utility Plant." Plaintiff was required to pay and paid fees to FERC, under the provision of 18 C.F.R. § 159.2(a) and § 159.2(b), based on the cost of construction of the Chiles Dome facility, including the cost of the native and injected cushion gas,

both recoverable and non-recoverable. The cost of cushion gas (both recoverable and non-recoverable) constitutes a part of the gas utility plant and is included as such in the rate base under the provisions of 18 C.F.R. § 154.63(f).

Both recoverable and non-recoverable cushion gas serve the same function in a gas storage facility. Cushion gas (both recoverable and non-recoverable) and surface compression serve the same general function in a gas storage facility. The cushion gas contained in the Chiles Dome gas storage facility (both recoverable and non-recoverable) is tangible property used as an integral part of furnishing gas services and the transportation of gas; additionally, it is a part of a facility the whole of which constitutes a natural gas bulk storage facility used by plaintiff in its business of furnishing gas service. The cushion gas contained in the Chiles Dome gas storage facility (both recoverable and non-recoverable) is not a building or its structural component.

With respect to the cushion gas purchased and injected into its Chiles Dome facility during 1981, plaintiff claimed, on its consolidated corporate income tax return for the year ending December 31, 1981, investment tax credit in the amount of $944,690.32 under the provisions of 26 U.S.C. § 38 and a deduction in the amount of $657,175.95 under the accelerated cost recovery provisions of 26 U.S.C. § 168. Also with respect to the cushion gas injected into Chiles Dome in 1981, plaintiff claimed accelerated cost recovery deductions in the amounts of $1,150,057.91, $985,763.93 and $821,469.94 on its consolidated corporate income tax returns filed for the years 1982, 1983 and 1984, respectively. Upon audit of plaintiff's tax returns for the years here at issue, the Internal Revenue Service proposed to disallow the investment tax credit and cost recovery deductions which plaintiff had claimed. Plaintiff then prepaid the asserted deficiencies and timely filed claims for refund, which either were denied or were not acted upon within 6 months after having been filed.

The cross-motions for partial summary judgment address plaintiff's entitlement to depreciation deductions and investment

tax credit for the recoverable cushion gas it purchased in 1981 in connection with its operation of the Chiles Dome gas storage facility. Material facts are not in dispute. Disposition by summary judgment is appropriate.

Plaintiff's motion for partial summary judgment contends that the entire volume of the cushion gas employed in the Chiles Dome gas storage facility (whether economically recoverable upon abandonment of the facility or not) constitutes "tangible property of a character subject to the allowance for depreciation" and thus constitutes "recovery property" within the meaning of I.R.C. § 168. Economically recoverable cushion gas, according to plaintiff, merely represents the salvage value of the cushion gas as a whole, and salvage value is irrelevant for purposes of determining the deduction provided by I.R.C. § 168. Availability of the investment tax credit provided by Section 38 turns upon the determination under I.R.C. § 168. On this sequence, plaintiff contends it is entitled to the cost recovery deductions and the investment tax credit with respect to the entire volume of its cushion gas placed in service after 1980.

With respect to the collateral estoppel defense, plaintiff contends the holding in Arkla I is inconsistent with prior holdings of this court, citing Transwestern Pipeline Co. v. United States, 639 F.2d 679 (Ct.Cl. 1980), and is erroneous as a matter of law in the conclusion that the economically recoverable and non-recoverable cushion gas should be treated as separate assets. Further, plaintiff argues that collateral estoppel does not preclude relitigation of the issues decided in Arkla I because the facts of the two cases are different, and because the law in this case differs from that there at issue. Different tax years are involved, and more importantly, this case involves the interpretation of different statutes than in Arkla I. Effective in 1981, I.R.C. § 48(a)(1) was amended, and I.R.C. § 168 was added.

Defendant's motion for partial summary judgment contends the facts in this case are identical to those considered in Arkla I, and that plaintiff's objections to the application of collateral estoppel here are without merit. Defendant argues: (1) the

applicable precedent holds that the mere fact that a different tax year is in suit does not preclude application of collateral estoppel; and (2) the amendment of I.R.C. § 48(a)(1) and the addition of I.R.C. § 168 are not relevant to the question of whether recoverable cushion gas is property eligible for depreciation, which is the dispositive issue in the instant case and was the dispositive issue in Arkla I.

Enactment of the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 97th Cong., 95 Stat. 172 (ERTA) resulted in amendment of I.R.C. § 48(a)(1) and the addition of I.R.C. § 168, effective for property placed in service after December 31, 1980. The investment tax credit allowed by I.R.C. § 38 applies to property as defined in I.R.C. § 48(a)(1), and new I.R.C. § 168 provided the Accelerated Cost Recovery System (ACRS) which applies to "recovery property" as defined in I.R.C. § 168(c).

Before the 1981 amendments, Section 38 property was defined in I.R.C., 48(a)(1)(B)(iii) as follows:

> **§ 48. Definitions; special rules**
> **(a) Section 38 property.--**
>
> **(1) In general.--** Except as provided in this subsection, the term "section 38 property" means--.
> . .
>
> > (B) other tangible property (not including a building and its structural components) but only if such property--. .
> > .
> >
> > > (iii) constitutes a facility used in connection with any of the activities referred to in clause (i) for the bulk storage of fungible commodities (including commodities in a liquid or gaseous state), or. . .

> Such term includes only property with respect to which depreciation (or amortization in lieu of depreciation) is allowable and having a useful life (determined as of the time such property is placed in service) of 3 years or more.

The 1981 amendments changed the final clause to read as follows:

Such term includes only recovery property (within the meaning of section 168 without regard to any useful life) and any other property with respect to which depreciation (or amortization in lieu of depreciation) is allowable and having a useful life (determined as of the time such property is placed in service) of 3 years or more. The preceding sentence shall not apply to property described in subparagraph (F) and, for purposes of this subpart, the useful life of such property shall be treated as its normal growing period.

The ACRS, I.R.C. § 168, was enacted to stimulate investment in assets that contribute to economic expansion by increasing the depreciation deductions available to taxpayers. I.R.C. § 168(a) provides:

§ 168. Accelerated cost recovery system

(a) Allowance of deduction.--There shall be allowed as a deduction for any taxable year the amount determined under this section with respect to recovery property.

Recovery property is defined generally in I.R.C. § 168(c) as follows:

(c) Recovery property.--For purposes of this title--

(1) Recovery property defined.--Except as provided in subsection (e), the term "recovery property" means tangible property of a character subject to the allowance for depreciation--

(A) used in a trade or business, or

(B) held for the production of income.

Certain property is excluded from ACRS. Recovery property does not include property placed in service before January 1, 1981, and does not include property the taxpayer elects to exclude. I.R.C. § 168(e). In the ACRS procedures, recovery property is assigned to one of five classes: 3 year property; 5 year property; 10 year property; 15 year real property; and 15 year public utility property. I.R.C. § 168(c)(2). The amount of allowable cost deductions with reference to each class is set forth in tables based on the periods the property was placed in service. I.R.C. § 168(b). For purposes of ACRS, salvage is irrelevant. Section 168(f)(9) provides:

(9) Salvage value.--No salvage value shall be taken into account in determining the deduction allowable under subsection (a).

I.R.C. § 48 does not provide a definition of "property with respect to which depreciation is allowable." I.R.C. § 167 provides the statutory definition "property with respect to which depreciation is allowable." The relevant portion of § 167(a), as in effect in 1980 and the years in suit, provided:

(a) General Rule.-- There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)--

(1) of property used in the trade or business;

(2) of property held for the production of income.

In the case of recovery property (within the meaning of section 168), the deduction allowable under section 168 shall be deemed to constitute the reasonable allowance provided by this section, except with respect to that portion of the basis of such property to which subsection (K) applies.

In 1981, I.R.C. § 167(a) was amended to prohibit a taxpayer from deducting the cost of an asset under both Section 167 and Section 168. This change does not affect the question of whether recoverable cushion gas is eligible for depreciation or the investment tax credit.

Treasury Regulation § 1.167(a)-2 provides in pertinent part:

Tangible property.--The depreciation allowance in the case of tangible property applies only to that part of the property which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence.

Rule 56 of the United States Court of Federal Claims requires judgment if there is "no genuine issue as to any material fact and the movant is entitled to judgment as a matter of law." The movant has the burden of demonstrating that there are no genuine issues of material fact. Adickes v. Kress, 398 U.S. 144, 157 (1970). In this case, each movant has met its burden by demonstrating that there is an absence of evidence on an essential element of the non-movant's case. Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1970); Sweat Fashions, Inc. v. Pannill Knitting Co., 833 F.2d 1560, 1563 (Fed. Cir. 1987). The cross-motions for partial summary judgment require the court to evaluate each party's motion on its own merits, taking care to draw all reasonable inferences against the party whose motion is under consideration. Mingus Constructors, Inc. v. United States, 812 F.2d 1387, 1391 (Fed. Cir. 1987).

* * * *

Collateral Estoppel Issue

Defendant asserts collateral estoppel as an affirmative defense. Under the doctrine of collateral estoppel, issue preclusion, "issues which are actually and necessarily determined by a court of competent jurisdiction are conclusive in a subsequent suit involving the parties to the prior litigation." Mothers Restaurant, Inc. v. Mama's Pizza, Inc., 723 F.2d 1566, 1569 (Fed. Cir. 1983). Four

elements are necessary for collateral estoppel to block a subsequent litigation: (1) identical issues, (2) actual litigation of those issues, (3) a determination of the issue which was necessary for the prior court's judgment, and (4) representation of the parties by counsel in the prior litigation. Mothers Restaurant, 723 F.2d at 1569. Plaintiff does not contest the applicability of parts two through four of the collateral estoppel test.

Arkla cites Comm'r v. Sunnen, 333 U.S. 591 (1948) for the law of collateral estoppel with respect to tax cases. The Sunnen court explained that collateral estoppel:

> avoid[s] an undue disparity in the impact of income tax liability. A taxpayer may secure a judicial determination of a . . . matter which may recur without substantial variation for some years thereafter. But a subsequent modification of the significant facts or a change or development in the controlling legal principles may make that determination obsolete or erroneous, at least for future purposes.

Sunnen, 333 U.S. at 599. The Court there stated that collateral estoppel in tax cases should be limited to situations in which the second case involves matters "identical in all respects with that decided in the first proceeding and where the controlling facts and applicable legal rules remain unchanged." Sunnen, 333 U.S. at 599. Arkla contends that both the facts and law of this case differ from those in Arkla I, and argues that collateral estoppel is not applicable.

Plaintiff correctly states that Arkla I concerned the availability of an investment tax credit for cushion gas injected prior to 1981, while the present case involves the availability of an ACRS deduction and an investment tax credit for cushion gas injected in 1981 forward. The factual differences between the two cases, however, must be material and have legal significance to preclude the operation of the collateral estoppel doctrine. Hercules Powder Co. v. United States, 167 Ct.Cl. 639, 644 (1964); see

Montana v. United States, 440 U.S. 147, 162 (1979) (the court should examine whether the "factual and legal context in which the issues of the case arise has not materially altered").

The difference in the purchase years of cushion gas and the additional ACRS issue present in this case is not necessarily material. See Murray v. United States, 426 F.2d 376, 381 (Ct.Cl. 1970) (collateral estoppel "applies in a later year to an issue which has been litigated in an earlier year" (citing Sunnen, 333 U.S. at 598-600)). Collateral estoppel avoids repetitious litigation on the "identical question of the statute's application to the taxpayer's status." McMullan v. United States, 686 F.2d 915, 918 (Ct. Cl. 1982) (quoting Tait v. Western Md. Ry., 289 U.S. 620, 634 (1933)). As long as the issues are the same, the fact that they arose in a different tax year will not prevent the operation of collateral estoppel. The outcome in this case turns on whether recoverable cushion gas is depreciable and therefore eligible for an investment tax credit or an ACRS deduction. The result in Arkla I also depended on whether recoverable cushion gas was depreciable.

Plaintiff is accurate in its argument that the law applicable in Arkla I has changed since the tax year at issue in that decision. I.R.C. § 168 became effective December 31, 1980 and section 48(a)(1) was amended. I.R.C. 168 allows deductions under the ACRS for "tangible property of a character subject to the allowance for depreciation." I.R.C. § 168 (c)(1). Whether property is subject to an allowance for depreciation, however, still is determined by I.R.C. § 167(a).

Under Sunnen, there must have been a change in the controlling law. The legal principles applicable to the decision in Arkla I remain the same. Plaintiff claims that section 168 (f)(9) changes the law because it states that "No salvage value shall be taken into account in determining the deduction allowable under subsection (a)." This law does not affect the threshold issue of whether certain property is depreciable. Consideration of salvage value's role in calculating the ACRS deduction is not an issue which defendant seeks to collaterally estop.

The linchpin of Arkla I and the decision in this case is whether the recoverable cushion gas is depreciable. The statute determining this issue, I.R.C. § 167, remains as before the 1981 amendments. Legislative history states that ACRS "does not change the determination under prior law as to whether property is depreciable or nondepreciable". General Explanation of The Economic Recovery Act of 1981 (Staff Report of the Joint Committee on Taxation, Dec. 29, 1981, p. 1451). This issues present in this case do not require the court to interpret these new and amended statutes unless the court finds the cushion gas to be subject to an allowance for depreciation. Therefore the law controlling the outcome of the depreciation issue is identical in Arkla I and Arkla II.

The Arkla I decision regarding the depreciable status of recoverable cushion gas collaterally estops this court from considering the same issue. The difference in tax years does not prevent collateral estoppel. Given that recoverable cushion gas is not depreciable, I.R.C. §§ 48 and 168 do not apply. These sections only affect the amount of the ACRS deduction or investment tax credit once an asset is subject to an allowance for depreciation.

ACRS Recovery Property.

Defendant contends, alternatively, it is entitled to partial summary judgment because recoverable cushion gas is not I.R.C. § 168 "recovery property" in that it is not property of a character subject to the allowance for depreciation.

The parties agree that the availability of an investment tax credit and ACRS deductions depends on whether cushion gas is recovery property under § 168. Plaintiff argues that all of its cushion gas is recovery property. The IRS ruled that economically recoverable cushion gas would not be recovery property because it was not subject to an allowance for depreciation.

Before ACRS and at the time of the Arkla I decision, depreciation reflected the physical exhaustion or economic obsolescence of an asset. The cost of an item less estimated

salvage value was distributed over the estimated useful life of the asset. ACRS standardized the useful life to decrease discrepancies among individual cases and eliminated the consideration of salvage value. Taxpayers' deductions under ACRS now relate to an asset's total cost.

Plaintiff alleges that the court in Arkla I and the IRS incorporated the concept of salvage value into their decisions by characterizing the economically recoverable part of the cushion gas as nondepreciable. Since salvage value is irrelevant under ACRS, plaintiff argues that the total cost of the entire cushion gas, one asset, is subject to ACRS deductions for depreciation.

Salvage value is measured by economic recoverability. Burnett v. Niagara Falls Brewing Co., 282 U.S. 648 (1931). Treasury Reg. § 1.167(a)-1(a) requires the depreciation allowance plus the salvage value to equal cost of property. The depreciation deduction was reduced by accounting for the salvage value; the existence of a salvage value, however, was not determinative of whether the asset was depreciable in the first place. The Arkla I decision did not discuss the salvage value of cushion gas. The court, however, did not have to consider salvage value in classifying an asset as depreciable or nondepreciable.

Defendant cites Revenue Ruling 75-233 as support for a division of cushion gas into recoverable and unrecoverable gas. The Ruling states that unrecoverable gas: "will remain permanently in place in the reservoir pore space at conditions of reservoir pressure and saturation initially projected for reservoir abandonment." Rev. Rul. 75-233, 1975-1 C.B. 95, 96. Recoverable cushion gas will not be permanently in the reservoir after abandonment. It will be sold. The Revenue Ruling in effect states that only non-recoverable gas qualifies as depreciable cushion gas.

Recoverable gas does not fit within the IRS or FERC definition of cushion gas. The taxpayer that was the subject of the Revenue Ruling had compiled engineering data and performance history of the gas and determined that a certain amount of gas

would be unrecoverable. The IRS only allowed depreciation of that amount. Plaintiff did a similar analysis to ascertain the recoverable amount of gas. Recoverable gas by its nature is not depreciable because it will not become obsolete and its cost can be fully recovered by resale. Since unrecoverable cushion gas has no salvage value, the Arkla I court analyzed the cushion gas correctly by categorizing it as two separate assets and by not calculating a salvage value.

The Arkla I court treated the economically recoverable cushion gas as a separate asset. In Hawaiian Independent Refinery, Inc. v. United States, 697 F.2d 1063 (Fed. Cir. 1983), the court held that all component parts of a facility functioned as a single property. The case at bar is similar because non-recoverable cushion gas is an integral part of the gas storage facility.

Plaintiff asserts that it is impossible to distinguish between recoverable and non-recoverable gas molecules, so there is really only one asset. Arkla contends that the purpose of placing recoverable and unrecoverable gas in separate accounts was merely to comply with the accounting classifications required by FERC. The FERC accounting rules, however, are "presumptively controlling" for tax purposes. Transwestern, 225 Ct. Cl. at 414 (citing Comm'r v. Idaho Power Co., 418 U.S. 1, 15 (1974)). Plaintiff admits that "based on engineering studies of the reservoir characteristics, the estimated extraction cost and the then prevalent cost of gas, it was determined that 2,986,607 MCF of the total 14 BCF of cushion gas could not be economically withdrawn upon abandonment of the facility." Accordingly, the categories of recoverable and non-recoverable cushion gas are not limited to FERC accounting mandates.

Transwestern Pipeline Co. v. United States, 225 Ct. Cl. 399 (1980), is binding precedent for this court. See South Corp. v. United States, 690 F.2d 1368 (Fed. Cir. 1982). In Transwestern, the line pack was determined to be depreciable and not an item of inventory. The court observed that line pack gas serves essentially the same function as cushion gas in that both are necessary to provide proper pressure in the gas storage facility or pipeline.

Only a small portion of the line pack, however, was seen as economically recoverable. The useful lives of line pack and cushion gas are equivalent to the useful life of the gas storage facility.

In Transwestern, because the line pack gas had some salvage value, the amount of the depreciation deduction was reduced. "[I]t reasonably appeared at the time when the line pack was injected into the plaintiff's pipeline system that the line pack would have some minor salvage value at the end of the system's useful life." Transwesten, 225 Ct. Cl. at 414-15. The court allowed a depreciation deduction based on the obsolescence of line pack gas, even though some of it was salvageable. Plaintiff asserts that the Transwestern analysis would need to be modified under the ACRS system. The deduction amount, according to plaintiff, would be based on the entire cost of the line pack.

The analysis in Transwestern referring to line pack is not relevant to the cushion gas at issue in this case. The Transwestern court describes the similarity of cushion gas and line pack gas in part by expressing that, both the line pack gas in a pipeline and the cushion gas in an underground storage reservoir are unrecoverable, except to a minor extent, at the end of the useful life of the respective facilities.

Transwestern, 225 Ct. Cl. at 411 (emphasis added). In the Transwestern analysis, if cushion gas were treated as line pack it would be economically feasible to recover only "between 3 percent and 20 percent" upon the ultimate abandonment of the storage facility. Transwestern, 225, Ct. Cl. at 415. In this case, plaintiff admits that approximately 80 percent of the cushion gas "could be economically withdrawn upon abandonment of the facility." With the great majority of cushion gas being recoverable in Arkla's situation, it is not similar to the concept of cushion gas as described in Transwestern.

Defendant distinguishes Transwestern because, in Transwestern, the "vast majority" of the line pack gas was non-recoverable while here there is not such a disparity between the

amounts. The fact that line pack and cushion gas have different salvage values should not necessarily affect whether their costs are depreciable. There is no regulation requiring a certain percentage salvage value in order to be a depreciable asset. However, the definition of cushion gas in Transwestern does not accurately describe the cushion gas at issue in the case at bar.

On the basis of the foregoing, defendant's motion for partial summary judgment on the cushion gas issue was allowed and plaintiff's cross-motion for partial summary judgment was denied.

Kenneth R. Harkins, Senior Judge

APPENDIX C

IN THE UNITED STATES COURT OF FEDERAL CLAIMS
No. 90-3954T

(Filed: September 13, 1993)

* *

ARKLA, INC.

Plaintiff,

v.

THE UNITED STATES,

Defendant.

* *

ORDER

Pursuant to order, oral argument was heard on August 20, 1993, in the United States Court of Federal Claims, National Courts Building, Washington, D.C. on plaintiff's motion for summary judgment on the line pack gas issue.

Appearances

For Plaintiff: Lawrence L. Jones, Esq.

For Defendant: G. Robson Stewart, Esq.

Relevant Papers

Complaint, filed November 16, 1990

Answer, filed March 28, 1991

Plaintiff's Motion for Summary Judgment and Memorandum in Support of Plaintiff's Motion for Summary Judgment, filed February 16, 1993

Appendix to Plaintiff's Motion for Summary Judgment and Memorandum in Support of Plaintiff's Motion for Summary Judgment, filed February 16, 1993

Defendant's Brief in Opposition to Plaintiff's Motion for Partial Summary Judgment, filed June 16, 1993

Defendant's Statement of Genuine Issues, filed June 16, 1993

Plaintiff's Memorandum in Response to Defendant's Brief in Opposition to Plaintiff's Motion for Partial Summary Judgment, filed July 2, 1993

Defendant's Motion for Leave to Cite Additional Authority in Support of the Defendant's Opposition to Plaintiff's Motion for Summary Judgment, and attachment, allowed July 29, 1993

Plaintiff's Motion for Leave to file Memorandum in Response to Defendant's Motion for Leave to Cite Additional Authority in Support of the Defendant's Opposition to Motion for Summary Judgment, and attached memorandum, allowed July 29, 1993

* * * * *

The complaint claims income tax refunds and assessed interest with respect to taxable years 1981-84 based on denials by the IRS on entitlements to deductions for recovery property under 26 U.S.C. §168 (ACRS) and denials of investment tax credits under 26 U.S.C. §38 (ITC). The refund claims concerned purchases of natural gas in 1981 for use as "cushion gas" in plaintiff's Chiles Dome gas storage facility, and for use as "line pack" in plaintiff's natural gas pipeline system.

Oral argument was heard on November 24, 1992, on cross motions for partial summary judgment on the cushion gas issue. At the close of argument, defendant's motion for partial summary judgment was allowed and plaintiff's cross-motion was denied. A memorandum of decision on the cushion gas issue (Arkla, Inc. v. United States, 27 Fed. Cl. 226 (1992) (Arkla II)) was filed on December 3, 1992.

The cushion gas issue and the line pack gas issue involve the same statutory provisions relative to investment tax credits and accelerated cost recovery system (ACRS). In Arkla II, the relevant statutes were considered, plaintiff's contentions concerning economic recoverability and salvage value were construed, and the analysis and holding of Transwestern Pipeline Co. v. United States, 225 Ct.Cl. 399 (1980) was discussed.

By order dated December 4, 1992, counsel were advised that plaintiff's claims on the cushion gas issue would be dismissed and counsel were encouraged to settle the line pack gas issue by stipulation. The parties were unable to settle the line pack gas issue by stipulation and plaintiff's February 16, 1993, motion for summary judgment on this issue followed.

During argument on August 20, 1993, it became apparent that the volume and value of the line pack gas injected in 1981, and the portion of the line pack gas that was economically recoverable, were material issues of fact in dispute. Plaintiff contends that the Court of Claims decision in Transwestern controls the ITC and ACRS issues, and that the amount of recoverability of the line pack gas is not relevant. Plaintiff further

argues the use of salvage value to limit the amount allowable is irrelevant under the ACRS depreciation scheme. Defendant argues that only the nonrecoverable portion of the line pack gas is eligible for the investment tax credit and cost recovery deductions. Defendant further contends that its position is consistent with the decision in Transwestern, i.e., that the recoverable portion of the line pack gas is not eligible for depreciation or investment tax credits.

At the close of argument, counsel were told that, in the absence of a stipulation on the material facts that were in dispute, summary judgment was not permissible. A schedule was established for the parties to attempt to negotiate and file a joint stipulation of the amount of line pack gas economically recoverable, and the volume and value of the line pack gas injected in 1981.

On September 2, 1993, the parties filed a joint stipulation of fact that defined the term "recoverable line pack gas" and stated:

> 2. During 1981, Arkla injected 18,532 MCF of line pack gas into its pipeline system at a cost of $36,520.48. Seventy percent (70%) of the line pack gas (12,846 MCF) injected by plaintiff in 1981 is economically recoverable.

On the record before the court there remains no genuine issue of material fact between the parties. Disposition of the line pack gas issue by summary judgment procedures is appropriate.

The decision in Transwestern is binding precedent for this court. See General Order No. 1, Oct. 7, 1982, and South Corp. v. United States, 690 F.2d 1368 (Fed. Cir. 1982) (all published decisions of the United States Court of Claims are binding precedent unless and until modified by decision of the Federal Circuit en banc or by the Supreme Court). In the Transwestern analysis, the cost of the line pack gas constituted a capital expenditure depreciable over the useful life of the system. Inasmuch as expert testimony indicated that it would be feasible

economically to recover between 3 and 20 percent of the line pack gas upon the ultimate abandonment of the pipeline system, the court made a "jury verdict" to determine that 12 percent should be regarded as recoverable. This amount was deducted from the volume eligible for depreciation. Transwestern, 225 Cl. Ct. at 414-15.

On the basis of the decision in Transwestern, plaintiff is entitled to recover on the line pack gas issue. Plaintiff is entitled to ITC and ACRS deduction on the amount of line pack gas injected during 1981 that is not economically recoverable.

Pursuant to the stipulation, nonrecoverable line pack gas injected in 1981 equals 5,506 MCF, with a value of $10,956.01. Plaintiff is entitled to a refund of 30 percent of the amount claimed as overpayment for investment tax credit (ITC) and ACRS deductions in each of the tax years, and statutory interest on the amount of refund for each year. The following table shows the amount of the overpayments that are to be refunded; it does not show the statutory interest applicable to each tax year.

OVERPAYMENT			REFUND		
	ITC	ACRS	ITC	ACRS	TOTAL
1981	$4,199.86	$2,083.91	$1,259.96	$ 625.17	$1,885.13
1982		838.15		251.45	251.45
1983		469.24		140.77	140.77
1984		426.59		127.98	127.98
			TOTAL		$2,405.33

Final Decision

1. Defendant's motion for partial summary judgment on the cushion gas issue is allowed. Plaintiff's claims on the cushion gas issue are dismissed.

2. (a) Plaintiff's motion for summary judgment on the line pack gas issue is allowed in part.

(b) On the line pack gas issue, plaintiff is entitled to a refund of $2,405.33, plus statutory interest on the amount allocable to each of the tax years.

3. The Clerk is directed to enter judgment for plaintiff in accordance with the foregoing. No costs.

Kenneth R. Harkins, Senior Judge

APPENDIX D

Statutory and Regulatory Provisions Involved

26 U.S.C. §38. Investment in certain depreciable property

(a) General rule. -- There shall be allowed, as a credit against the tax imposed by this chapter, the amount determined under subpart B of this part.

(b) Regulations. -- The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section and subpart B.

26 U.S.C. §48. Definitions; special rules

(a) Section 38 property. --

(1) In general. -- Except as provided in this subsection, the term "section 38 property" means--

* * *

(B) other tangible property (not including a building and its structural components) but only if such property--

(i) is used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or

* * *

(iii) constitutes a facility used in connection with any of the activities referred to in clause (i) for the bulk storage of fungible commodities (including commodities in a liquid or gaseous state), or

26 U.S.C. §167. Depreciation

(a) General rule.--There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)--

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * *

(f) Salvage value. --

(1) General rule. -- Under regulations prescribed by the Secretary, a taxpayer may, for purposes of computing the allowance under subsection (a) with respect to personal property, reduce the amount taken into account as salvage value by an amount which does not exceed 10 percent of the basis of such property (as determined under subsection (g) as of the time as of which such salvage value is required to be determined).

(2) Personal property defined. -- For purposes of this subsection, the term "personal

property" means depreciable personal property (other than livestock) with a useful life of 3 years or more acquired after October 16, 1962.

26 U.S.C. §168. Accelerated cost recovery system

(a) Allowance of deduction. -- There shall be allowed as a deduction for any taxable year the amount determined under this section with respect to recovery property.

* * *

(c) Recovery property. -- For purposes of this title --

(1) Recovery property defined. -- Except as provided in subsection (e), the term "recovery property" means tangible property of a character subject to the allowance for depreciation --

(A) used in a trade or business, or

(B) held for the production of income.

* * *

(f) Special rules for application of this section. -- For purposes of this section.

* * *

(9) Salvage value. -- No salvage value shall be taken into account in determining the deduction allowable under subsection (a).

Treas. Regs.:

§1.167(a)-1. **Depreciation in general.** -- (a) *Reasonable allowance.* Section 167(a) provides that a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business or of property held by the taxpayer for the production of income shall be allowed as a depreciation deduction. The allowance is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), so that the aggregate of the amounts set aside, plus the salvage value, will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of the property as provided in section 167(g) and §1.167(g)-1. An asset shall not be depreciated below a reasonable salvage value under any method of computing depreciation. However, see section 167(f) and §1.167(f)-1 for rules which permit a reduction in the amount of salvage value to be taken into account for certain personal property acquired after October 16, 1962. See also paragraph (c) of this section for definition of salvage. The allowance shall not reflect amounts representing a mere reduction in market value. See section 179 and §1.179-1 for a further description of the term "reasonable allowance."

§1.167(a)-2. **Tangible property.** -- The depreciation allowance in the case of tangible property applies only to that part of the property which is subject to wear and tear, to decay or decline from natural causes, to exhaustion,and to obsolescence. The allowance does not apply to inventories or stock in trade, or to land apart from the improvements of physical development added to it. The allowance does not apply to natural resources which are subject to the allowance for depletion provided in section 611. No deduction for depreciation shall be allowed on automobiles or other vehicles used solely for pleasure, on a building used by the taxpayer solely as his residence, or on furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as a theatrical business, may be depreciated.

Proposed Treas. Reg.

§1.168-2(1)(2)

* * *

(l) *Definitions.* For purposes of section 168 and §§ 1.168-1 through 1.168-6 --

* * *

(2) *Placed in service.* The term "placed in service" means the time that property is first placed by the taxpayer in a condition or state of readiness and availability for a specifically assigned function, whether for use in a trade or business, for the production of income, in a tax-exempt activity, or in a personal activity. In the case of a building which is intended to house machinery and equipment, such readiness and availability shall be determined without regard to whether the machinery or equipment which the building houses, or it intended to house, has been placed in service. However, in an appropriate case, as, for example, where the building is essentially an item of machinery or equipment, or the use of the building is so closely related to the use of the machinery or equipment that it clearly can be expected to be replaced or retired when the property it initially houses is replaced or retired, the determination of readiness or availability of the building shall be made by taking into account the readiness and availability of such machinery or equipment. For a building which becomes available for use in separate stages, see paragraph (e)(3) of this section.

Supreme Court, U.S.
FILED
MAR 7 1995
OFFICE OF THE CLERK

No. 94-1183

In the Supreme Court of the United States

OCTOBER TERM, 1994

NORAM ENERGY CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

DREW S. DAYS, III
Solicitor General

LORETTA C. ARGRETT
Assistant Attorney General

JONATHAN S COHEN
THOMAS J. CLARK
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 514-2217

BEST AVAILABLE COPY

QUESTION PRESENTED

Whether collateral estoppel bars petitioner from asserting that the recoverable portions of its cushion gas and line pack gas are subject to the allowance for depreciation for federal income tax purposes.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	4
Conclusion	8

TABLE OF AUTHORITIES

Cases:

Arkla, Inc. v. *United States*, 765 F.2d 487 (5th Cir. 1985), cert. denied, 475 U.S. 1064 (1985)	3, 5
Commissioner v. *Sunnen*, 333 U.S. 591 (1948)	7
Limbach v. *Hooven & Allison Co.*, 466 U.S. 353 (1984)	7
Montana v. *United States*, 440 U.S. 147 (1979)	5, 7
Newark Morning Ledger Co. v. *United States*, 113 S. Ct. 1670 (1993)	5
Parklane Hosiery Co. v. *Shore*, 439 U.S. 322 (1979)	4
Transwestern Pipeline Co. v. *United States*, 639 F.2d 679 (Ct. Cl. 1980)	7
United States v. *Stauffer Chemical Co.*, 464 U.S. 165 (1984)	5

Statutes:

Internal Revenue Code (26 U.S.C.):	
§ 38	2, 3
§ 46	5
§ 48	5
§ 167(a)	5
§ 168	3
§ 168(f)(9) (1982)	6

In the Supreme Court of the United States

OCTOBER TERM, 1994

No. 94-1183

NORAM ENERGY CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-14a) is reported at 37 F.3d 621. The Court of Federal Claims issued two opinions. The first (Pet. App. 15a-32a) is reported at 27 Fed. Cl. 226. The second (Pet. App. 33a-38a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on October 4, 1994. The petition for a writ of certiorari was filed on December 30, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner operates a natural gas pipeline system through which it transmits natural gas for sale to customers in Arkansas, Louisiana, Kansas, Oklahoma and Texas (Pet. App. 3a-5a). Petitioner also operates an underground gas reservoir known as the Chiles Dome in which it temporarily stores gas for future sales (*ibid.*).

In order for the Chiles Dome facility to operate at peak efficiency, petitioner maintained a constant quantity of gas, known as "cushion gas," within the reservoir (Pet. App. 3a). Similarly, in order for petitioner's pipeline system to operate efficiently, it was necessary to maintain a constant quantity of gas, known as "line pack gas," within the system (*id.* at 4a-5a). The gas that is referred to as "cushion gas" and "line pack gas" is physically indistinguishable from the natural gas delivered to petitioner's customers (*id.* at 17a). The terms simply refer to the quantity of gas required to maintain the optimal pressure in the reservoir and pipeline system (*ibid.*).

Cushion gas and line pack gas are largely recoverable; they can be withdrawn and sold upon abandonment of the reservoir or the pipeline system (Pet. App. 3a). The portion of cushion and line pack gas that cannot economically be withdrawn is referred to as "nonrecoverable" gas.

2. In 1980, petitioner purchased gas for injection into the Chiles Dome reservoir as cushion gas (Pet. App. 3a). Petitioner claimed an investment tax credit under 26 U.S.C. 38 for the entire cost of that cushion gas (Pet. App. 3a-4a). When the Internal Revenue Service disallowed the claimed credit, petitioner paid the resulting deficiency and sued for a refund in the United

States District Court for the Western District of Louisiana (*id.* at 4a).

The district court granted summary judgment for petitioner, but the court of appeals reversed. *Arkla, Inc.* v. *United States*, 765 F.2d 487 (5th Cir. 1985) (*Arkla I*), cert. denied, 475 U.S. 1064 (1986).[1] The court noted that the investment tax credit is available only for depreciable property. *Id.* at 489. The recoverable portion of petitioner's cushion gas was not depreciable, however, because it would remain unchanged in the reservoir for an indefinite period of time and could be retrieved and sold when the reservoir was closed. *Id.* at 490. The investment tax credit was therefore not applicable to petitioner's cushion gas. *Ibid.*

3. In 1981, petitioner purchased additional cushion gas for the Chiles Dome reservoir (Pet. App. 4a). Petitioner claimed both the investment tax credit under 26 U.S.C. 38 and a deduction for depreciation under 26 U.S.C. 168 for the recoverable and nonrecoverable portions of that cushion gas (Pet. App. 4a). Petitioner also claimed the investment tax credit and a depreciation deduction for line pack gas it purchased and placed in service in 1981 (*id.* at 5a).

When the IRS disallowed the claimed investment tax credits and depreciation deductions, petitioner paid the deficiencies and filed suit for refund in the Court of Federal Claims (Pet. App. 4a). That court held that petitioner was entitled to a refund for the portion of the disputed claim that related to the *non*recoverable cushion and line pack gas (*ibid.*). The court further held that the decision in *Arkla I* collaterally estopped petitioner from claiming an investment tax credit and

---

[1] Petitioner was named "Arkla, Inc." prior to May of 1994 (Pet. ii).

depreciation deduction for the recoverable portion of its cushion gas (Pet. App. 4a). On the merits, the court also held that petitioner was not entitled to the investment tax credit or a depreciation deduction for the recoverable portion of its line pack gas (*id.* at 5a).

4. The court of appeals affirmed. The court agreed with the Court of Federal Claims that collateral estoppel barred petitioner from relitigating the question whether its recoverable cushion gas was depreciable (Pet. App. 6a-12a). The court also held that petitioner was collaterally estopped from arguing that its line pack gas was depreciable on the ground that there was no material factual difference between line pack gas and cushion gas (*id.* at 12a-13a).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

The doctrine of collateral estoppel bars parties to a prior lawsuit from relitigating any issue that was actually and necessarily determined by a court of competent jurisdiction in the prior suit. *Parklane Hosiery Co.* v. *Shore*, 439 U.S. 322, 326 n.5 (1979). The doctrine serves "the dual purpose of protecting litigants from the burden of relitigating an identical issue with the same party or his privy and of promoting judicial economy by preventing needless litigation." *Id.* at 326. Collateral estoppel will apply if (i) the party against whom estoppel is asserted was a party in the prior action, or a privy to a party, (ii) the issue sought to be relitigated is identical to the one decided in the prior action, (iii) the controlling facts and legal principles remain unchanged, and (iv) no special circumstances

warrant an exception to the otherwise applicable rules of preclusion. *United States* v. *Stauffer Chemical Co.*, 464 U.S. 165, 169 (1984); *Montana* v. *United States*, 440 U.S. 147, 155 (1979).

a. In *Arkla I*, petitioner claimed that it was entitled to the investment tax credit for the recoverable portion of the cushion gas it acquired and injected into the Chiles Dome facility in 1980. The investment tax credit is allowable only for property that is subject to the allowance for depreciation. 26 U.S.C. 46, 48. Property is depreciable only if, among other things, it is subject to exhaustion, wear and tear and has a determinable useful life. 26 U.S.C. 167(a). See *Newark Morning Ledger Co.* v. *United States*, 113 S. Ct. 1670, 1680-1681 (1993) (property is depreciable only if it "has a value that wastes over an ascertainable period of time"). In *Arkla I*, the Fifth Circuit held that petitioner's recoverable cushion gas is not depreciable because it will not waste and, at the end of the storage facility's useful life, it "will be available for sale or other use, with its general utility and value undiminished in any fashion." 765 F.2d at 490.

The parties and the issue in the instant case are identical to those in *Arkla I*. Although in *Arkla I* petitioner claimed entitlement only to the investment tax credit, while here it claims both the investment tax credit and depreciation deductions, both of those tax benefits are available only for property that is subject to exhaustion, wear and tear and has an ascertainable useful life. In *Arkla I*, the recoverable portions of petitioner's gas were held not to meet that standard. 765 F.2d at 490.

b. The controlling facts and legal principles involved in this case are identical to those involved in *Arkla I*. The two factual differences between this case and *Arkla I* are not material: (i) This case concerns cushion gas

petitioner placed in service in 1981, while *Arkla I* involved cushion gas placed in service in 1980. The decision in *Arkla I*, however, did not turn on the year in which the non-depreciable gas was placed in service. (ii) This case, unlike *Arkla I*, involves "line pack gas" as well as "cushion gas." As the court of appeals noted (Pet. App. 12a), however, line pack gas is "functionally equivalent" to cushion gas for both are used merely to maintain an optimal constant pressure in a gas facility. The controlling fact with regard to line pack gas, as with cushion gas, is that the recoverable portion of that gas is not a wasting asset and has no ascertainable useful life (*id.* at 12a-13a).

c. No change in the controlling legal principles occurred between the 1980 and 1981 tax years. Both *Arkla I* and this case turn on whether petitioner's recoverable gas is depreciable, and there was no change in the definition of depreciable property between 1980 and 1981. Petitioner argues (Pet. 16) that a change in the controlling legal principles was effected by the addition of Section 168 to the Internal Revenue Code, effective for property placed in service after December 31, 1980. Petitioner alludes to 26 U.S.C. 168(f)(9) (1982), under which salvage value is not to be considered in determining the amount of depreciation deductions. That provision affects only the calculation of the deduction when applicable; it does not alter the definition of depreciable property as property that is subject to exhaustion, wear and tear and that has a determinable useful life. Petitioner's line pack and cushion gas do not qualify under that definition (Pet. App. 12a-13a).[2]

---

[2] Petitioner claims (Pet. 17) that collateral estoppel should not be applied because *Arkla I* itself effected a change in law. The contention that the earlier decision was incorrect (or otherwise not

d. Petitioner errs in contending (Pet. 6-9) that the decision in this case conflicts with this Court's decisions in *Commissioner* v. *Sunnen*, 333 U.S. 591 (1948), and *Limbach* v. *Hooven & Allison Co.*, 466 U.S. 353 (1984). In those cases, the Court held that collateral estoppel would not apply where different tax years are in issue if there has been an intervening change in the law. 466 U.S. at 362. See also *Montana* v. *United States*, 440 U.S. at 161 (collateral estoppel did not apply in *Sunnen* because "there had been a 'significant change in the legal climate'"). A corollary to this rule is that, so long as the controlling legal principles remain unchanged, collateral estoppel will apply even though—as in this case—a subsequent lawsuit places a different tax year in issue.

e. Finally, petitioner argues (Pet. 16-18) that collateral estoppel should not apply in this case because, if the decision of the court of appeals is allowed to stand, two taxpayers within the same circuit will be treated differently. Petitioner asserts that the taxpayer in *Transwestern Pipeline Co.* v. *United States*, 639 F.2d 679 (Ct. Cl. 1980), will receive tax treatment more favorable than petitioner has received. That contention, which lacks legal merit in any event, is simply factually incorrect. In *Transwestern*, the taxpayer was allowed to depreciate only the *non*recoverable portion of its line pack gas; it was not permitted to depreciate its recoverable gas. See 639 F.2d at 681 (allowing depreciation of "economically unrecoverable gas"); *id.* at 688 (dis-

---

in conformity with established law at the time it was entered) is, however, precisely the type of collateral challenge to the prior determination that collateral estoppel does not permit. Only a subsequent change in controlling legal principles may justify an exception from collateral estoppel. See *Montana* v. *United States*, 440 U.S. at 161.

allowing deduction for "recoverable and salvageable" line pack gas). That is identical to the tax treatment afforded to petitioner by the decision below (Pet. App. 5a, 13a).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

LORETTA C. ARGRETT
Assistant Attorney General

JONATHAN S. COHEN
THOMAS J. CLARK
Attorneys

MARCH 1995

Supreme Court, U.S.
FILED
MAR 15 1995
OFFICE OF THE CLERK

(3)

No. 94-1183

In the Supreme Court of the United States

OCTOBER TERM, 1994

NORAM ENERGY CORP.,
Petitioner,

v.

THE UNITED STATES,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

PETITIONER'S REPLY MEMORANDUM

FREDERICK R. PARKER, JR.
Beck Building
400 Travis Street
Shreveport, Louisiana 71101-3183
(318)221-4396

*LAWRENCE L. JONES
J. EDGERTON PIERSON, JR.
BLANCHARD, WALKER, O'QUIN & ROBERTS
(A Professional Law Corporation)
P.O. Drawer 1126
Shreveport, LA 71163-1126
(318)221-6858

Counsel for Petitioner

**Counsel of Record*
March 15, 1995

BEST AVAILABLE COPY

TABLE OF CONTENTS

TABLE OF CONTENTS i

TABLE OF AUTHORITIES ii

ARGUMENT. 1

I. The Effect of *Montana* on the Continuing Validity of the *Sunnen* "Separable Facts" Analysis 1

II. Whether the Application of Collateral Estoppel in this Case Would Result in the Inequitable Administration of the Revenue Laws 3

CONCLUSION 6

TABLE OF AUTHORITIES

Cases

Arkla, Inc. v. United States,
765 F.2d 487 (5th Cir. 1985) 2, 3, 4, 6

Comm'r v. Sunnen,
333 U.S. 591, 68 S.Ct. 715,
92 L.Ed.2d 898 (1948) 2

Limbach v. Hooven & Allison Co.,
466 U.S. 353, 104 S.Ct. 1837,
80 L.Ed.2d 356 (1984) 2

Montana v. United States,
440 U.S. 147, 59 L.Ed.2d 210,
99 S.Ct. 970 (1979) 2

*Transwestern Pipeline Company v.
United States*, 639 F.2d 679,
225 Cl.Ct. 999 (1980) 3, 4, 6

United States v. Moser, 266 U.S.
236, 69 L.Ed. 262, 45 S.Ct. 66 (1924) 5

United States v. Stauffer Chemical Co.,
464 U.S. 165, 104 S.Ct. 575,
78 L.Ed.2d. 388 (1984) 3, 4, 5, 6

Other Authorities

Griswold, *Res Judicata in Federal Tax Cases*,
46 Yale L.J. 1320 (1937) 2

Scott, *Collateral Estoppel By Judgment*,
56 Harv.L.Rev. 1 (1942) 5

Wright, Miller & Cooper, *Federal Practice and Procedure: Jurisdiction* §4425 . . . . . 2, 5

NO. 94-1183

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1994

NORAM ENERGY CORP.,

Petitioner,

v.

THE UNITED STATES,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

PETITIONER'S REPLY MEMORANDUM

ARGUMENT

The Respondent submits essentially two erroneous arguments in support of its contention that the appeals court properly applied the doctrine of collateral estoppel to bar the Petitioner from litigating the purely legal question presented in this case. Each of these arguments will be addressed in turn.

I. The Effect of *Montana* on the Continuing Validity of the *Sunnen* "Separable Facts" Analysis

First, the Respondent contends that collateral estoppel applies here because the parties, facts, legal issues and legal principles which were before the Federal Circuit in this case are

identical to those which were before the Fifth Circuit in *Arkla, Inc. v. United States*, 765 F.2d 487 (5th Cir. 1985), *cert. denied*, 475 U.S. 1064 (1986) ("*Arkla I*"). The Respondent dismisses as irrelevant the fact that *Arkla I* involved an asset placed in service in 1980, whereas this case involves physically-distinct, but functionally-equivalent, assets placed in service the following year. The Respondent thus rejects the continued viability of the "separable facts" analysis originally laid down by this Court in *Comm'r v. Sunnen*, 333 U.S. 591, 68 S.Ct. 715, 92 L.Ed.2d 898 (1948), and instead reads *Sunnen* and its sequel, *Limbach v. Hooven & Allison Co.*, 466 U.S. 353, 104 S.Ct. 1837, 80 L.Ed.2d 356 (1984), as standing for the proposition that only an intervening change in the law will prevent the application of collateral estoppel in the tax setting. The Respondent relies upon this Court's holding in *Montana v. United States*, 440 U.S. 147, 59 L.Ed.2d 210, 99 S.Ct. 970 (1979), in support of this contention, arguing that this later case tempered the original *Sunnen* analysis.

The Petitioner first would note that this case in fact poses such an intervening change in the law as the Respondent contends is necessary to preclude the application of collateral estoppel (see the discussion in Part II, below.) Moreover, and without regard to the existence of an intervening change in the law, the Petitioner construes the *Hooven* decision as a reaffirmation of the original *Sunnen* analysis regarding the narrow application of collateral estoppel in tax cases. This conclusion also may be found in the writings of several noted commentators who have expressed the view that the issues of fairness which pervade tax litigation present a strong case for continued adherence to the *Sunnen* rule. These commentators argue that, as long as separable facts are involved, relitigation should be permitted even with respect to identical issues of law application.[1]

---

[1]See, *e.g.*, Griswold, *Res Judicata in Federal Tax Cases*, 46 Yale L.J. 1320 (1937); Wright, Miller & Cooper, *Federal Practice and Procedure: Jurisdiction* §4425.

The arguments presented on both sides of this issue highlight the confusion which now surrounds the application of collateral estoppel in tax cases This uncertainty regarding the proper application of a legal principle by which one's very right to litigate a tax controversy will either live or die behooves this Court to grant a Writ of Certiorari in this case and clarify this issue which is of significance to all taxpayers and taxing jurisdictions.

II. Whether the Application of Collateral Estoppel in this Case Would Result in the Inequitable Administration of the Revenue Laws

The Respondent also contends that the application of collateral estoppel in this case will not result in the sort of injustice of which the Petitioner complains, arguing that there will be no disparity in the treatment of taxpayers within the Federal Circuit because the Court of Claims reached the same result in *Transwestern Pipeline Co. v. United States*, 639 F.2d 679, 225 Cl. Ct. 999 (1980), as did the Fifth Circuit in *Arkla I*. Specifically, the Respondent argues that "[i]n *Transwestern*, the taxpayer was allowed to depreciate only the *non*recoverable portion of its line pack gas; it was not permitted to depreciate its recoverable gas." (Opp. p.7). The Respondent thus argues that this case does not present the pivotal issue raised by Justice White in *United States v. Stauffer Chemical Co.*, 464 U.S. 165, 104 S.Ct. 575, 78 L.Ed.2d. 388 (1984), but which has yet to be addressed by the majority of this Court; *i.e.*, whether a taxpayer who raises an issue of law within any particular circuit is entitled to be treated the same as all other taxpayers who raise the same issue within that circuit.

The Respondent's argument rests upon a misstatement of the *Transwestern* holding. Although the *Transwestern* court and the Fifth Circuit in *Arkla I* may have reached the same *result* under prior law, their *analyses* could not have been more inconsistent, as revealed by a subsequent change in the law. The *Transwestern* court concluded that the economically-recoverable volume of line pack gas constitutes the salvage value of the gas as a whole and,

under the prior law depreciation scheme, reduced the *amount* of the depreciation deductions to reflect the existence of this salvage value. The Fifth Circuit in *Arkla I*, on the other hand, concluded that the economically-recoverable and nonrecoverable volumes of cushion gas represent entirely separate and distinct assets. Because salvage value was a critical component in determining the allowance for depreciation with respect to any asset placed in service before 1981, either of these analyses would have led to the same result regarding the amount of depreciation deductions available in any action brought under prior law. The new provision of the law under which this action was brought, however, changed the depreciation scheme with respect to assets placed in service after 1980 by eliminating salvage value as a factor in determining the amount of allowable depreciation deductions. Thus, while the economically-recoverable volumes of the Petitioner's line pack and cushion gas would be eligible for depreciation under the *Transwestern* salvage value analysis, they would not be depreciable under the *Arkla I* separate asset analysis.[2] It is this change in the law which presents the very potential for the unequal administration of the revenue laws with which Justice White was concerned. Accordingly, this case presents this Court with the opportunity to resolve precisely the issue raised by Justice White's concurrence in *Stauffer Chemical*.

---

[2]The *Transwestern* court clearly equated the economically-recoverable line pack gas with the salvage value of the line pack as a whole:

. . . it must be noted that the plaintiff depreciated the entire cost of the line pack on the theory that it would be wholly lost and would have no *salvage value* at the end of the pipeline system's useful life. The evidence in this record shows that, on the contrary, it reasonably appeared at the time when the line pack was injected into the plaintiff's pipeline system that the line pack would have some minor *salvage value* at the end of the system's useful life. . . . A "jury verdict" to the effect that the line pack should be regarded as recoverable and *salvageable* to the extent of 12 percent would seem to be appropriate for present purposes, and this is included in the findings of fact. 639 F.2d 679, 688.

The foundation for Justice White's analysis best reveals the nature of the Federal Circuit's fundamental error in this case. Justice White reasoned, in general, that relitigation of an issue should be permitted if the issue is one of law and a new determination is warranted to implement an intervening change in the law or to avoid the inequitable administration of the law. This conclusion was founded upon the notion that, because the law is dynamic, the doctrine of collateral estoppel should be applied in a manner so as to ensure litigants only the benefit of prior *litigation*, as opposed to the benefit of a prior *ruling*. Accordingly, Justice White emphasized that the doctrine does not apply to preclude relitigation of a pure issue of law, noting that "the distinction is between an abstract legal proposition and the application of that proposition to particular facts."[3] Thus, while collateral estoppel furthers the interest of ensuring reliance on adjudicated matters by protecting a judgment once rendered from later being attacked by the losing party in another case, the doctrine does not preclude the unsuccessful litigant from later challenging the validity of the rule laid down in the first case as an abstract proposition of law. Collateral estoppel thus historically has not been applied to burden the losing party with an erroneous rule of law in any subsequent action between the same parties.[4] This is so because it would be manifestly unjust to forever apply the erroneous rule of law as to the once unsuccessful litigant, yet to apply the correct rule to any person not bound by the earlier judgment.

It would be equally unjust to preclude the Petitioner from litigating in the Federal Circuit the purely legal question posed in this case. First, all of the relevant facts in this case were

---

[3]See Justice White's concurring opinion in *Stauffer Chemical*, 464 U.S. at 181, n.2. This Court has long held that the doctrine of collateral estoppel does not apply to pure questions of law. See, *e.g.*, *United States v. Moser*, 266 U.S. 236 at 241, 69 L.Ed. 262, 45 S.Ct. 66 (1924); and Scott, *Collateral Estoppel By Judgment*, 56 Harv.L.Rev. 1, 7 (1942). See also Wright, Miller & Cooper, *supra*, n. 1.

[4]Scott, *supra*, n. 3.

stipulated, and the matter was submitted to the United States Court of Federal Claims for decision on cross motions for summary judgment. The case thus involves no question of fact, but is limited to a theoretical construction of the relevant provisions of the Internal Revenue Code as construed in the light of Congressional intent. In particular, this case involves the abstract legal question of whether the economically-recoverable portion, element, or value which an asset may have upon its abandonment or other disposition should be treated as the salvage value of that asset (under the *Transwestern* analysis) or as an entirely separate and distinct asset (under the *Arkla I* analysis) for purposes of determining whether it constitutes "property of a character subject to the allowance for depreciation" within the meaning of Section 168 of the Internal Revenue Code. The greatest irony which stems from the Federal Circuit's holding in this case is found in the fact that the Petitioner would not have been collaterally estopped from again arguing this question of law even before the Fifth Circuit, which decided *Arkla I*. How, then, can the Federal Circuit purport to deny the Petitioner the right to relief under its own jurisprudence? This alone illustrates the inherent inequity which would result should the Federal Circuit's holding be allowed to stand.

CONCLUSION

The arguments submitted by the Petitioner and the Respondent concerning whether this Court should grant a Writ of Certiorari in this case attest to the confusion which abounds on the part of both the courts and the bar concerning the proper application of collateral estoppel in tax cases. In light of the definitive nature of the collateral estoppel doctrine in terms of the rights of litigants, this Court must grant a Writ of Certiorari to eliminate the prevailing uncertainty.

Further, this case presents precisely the issue posed by Justice White's concurrence in *Stauffer Chemical*, but which the majority of this Court has yet to address. This case thus presents the Court with the opportunity to resolve this issue and provide the

much-needed guidance concerning the proper role of collateral estoppel in the tax context. Accordingly, the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

LAWRENCE L. JONES
Counsel of Record

J. EDGERTON PIERSON, JR.
BLANCHARD, WALKER, O'QUIN & ROBERTS
(A Professional Law Corporation)
1400 Premier Bank Tower
Shreveport, Louisiana 71101
(318)221-6858

FREDERICK R. PARKER, JR.
1601 Beck Building
400 Travis Street
Shreveport, Louisiana 71101
(318)222-4396

Counsel for Petitioner